

THE
BUDGET DEAL
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► IS EUROPE IN FOR RECESSION? ► MUTUAL FUND UPDATE

BusinessWeek

OCTOBER 15, 1990

A MCGRAW-HILL PUBLICATION

\$2.00

APPLE COMPUTER

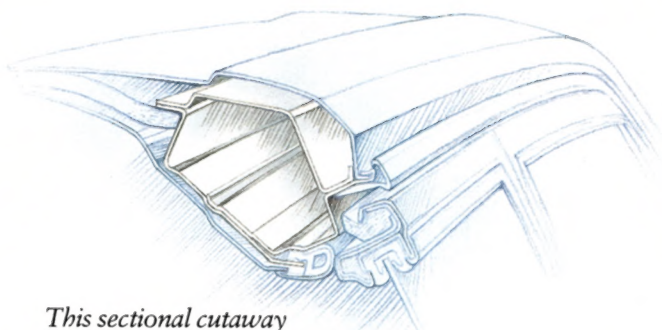
New
Team,
New
Strategy

With sales stalled
and market share slipping,
Apple is making big
changes: lower prices,
new models, and
ultimately a successor
to the Macintosh.

CEO
John Sculley
(right) and
new No. 2
Michael
Spindler



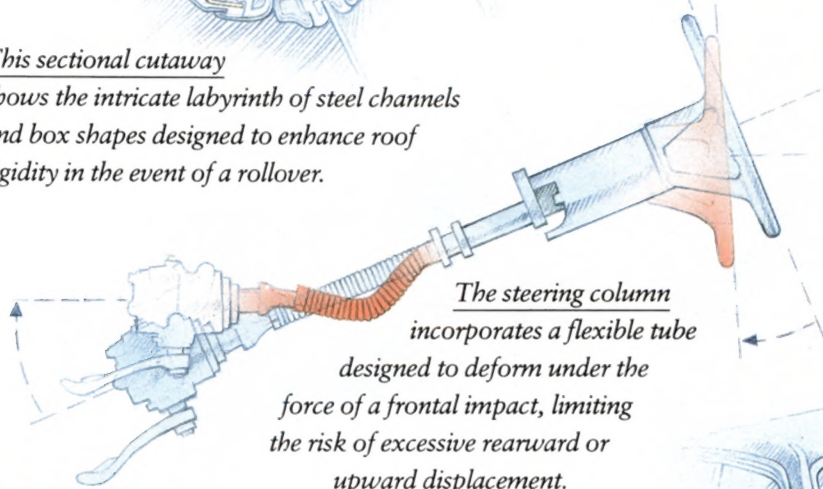
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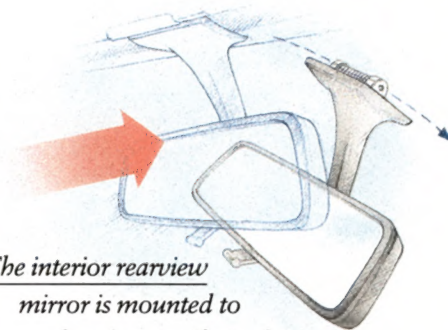
This sectional cutaway shows the intricate labyrinth of steel channels and box shapes designed to enhance roof rigidity in the event of a rollover.



The exterior door handle is not a styled flap but a sturdy grip. Its looped shape is meant to permit maximum pulling force should rescue assistance ever be needed.



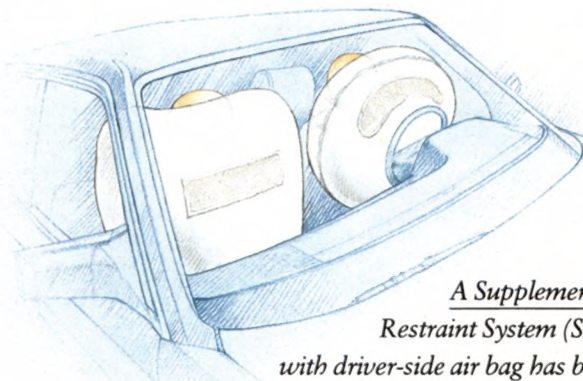
The steering column incorporates a flexible tube designed to deform under the force of a frontal impact, limiting the risk of excessive rearward or upward displacement.



The interior rearview mirror is mounted to break away if struck with moderate force.

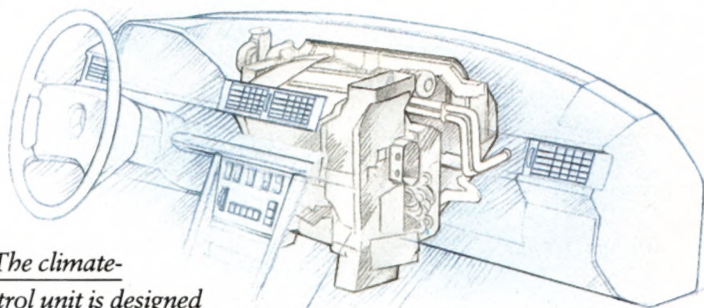
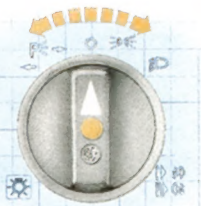


The frontal structure is designed to absorb and channel kinetic energy not only in head-on but also offset frontal impacts—more frequent and more severe. Mercedes-Benz pioneered both the basic energy-absorbing body concept and this offset enhancement.



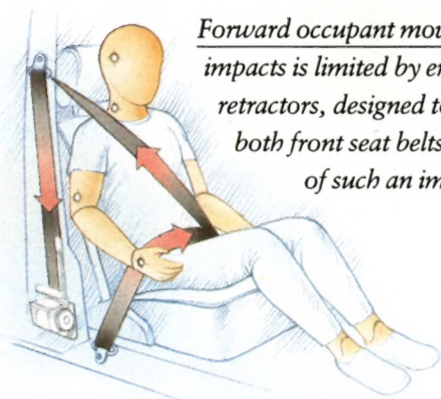
A Supplemental Restraint System (SRS) with driver-side air bag has been standard in every Mercedes-Benz since 1985. On many models, the system now includes both driver and front passenger air bags.

Like every interior control and lever, this recessed headlight-control switch is designed and shaped and placed to help reduce the chance of occupant injury in a severe impact.



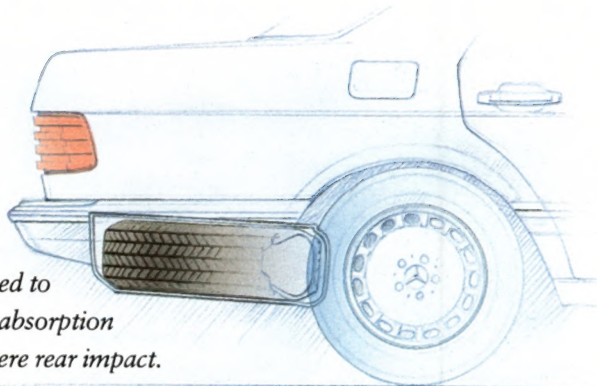
The climate-control unit is designed to be crushable in a severe impact, minimizing the risk of its being pushed rearward into the passenger area.





Forward occupant movement in certain impacts is limited by emergency tensioning retractors, designed to tighten slack in both front seat belts within milliseconds of such an impact.

The spare tire's placement is designed to add extra energy absorption in case of a severe rear impact.

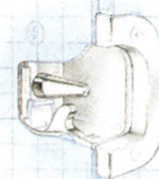


A crash course in Mercedes-Benz

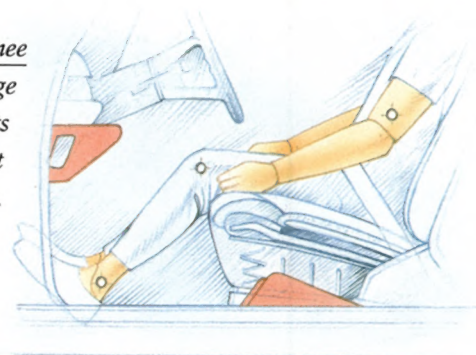


A wedge-shaped seat insert and a padded knee bolster on the instrument panel's lower edge combine to help prevent front occupants from "submarining" under their seat belts in a severe frontal impact.

An aluminum sheet is inserted among the layers of wood on critical dashboard areas to help prevent splintering under the force of a direct impact.



Recognizing the importance of keeping occupants inside the car in a severe impact, Mercedes-Benz places extreme importance on door-lock design. This cone-type lock was patented in 1959 and has since been steadily refined.



The most effective single safety element is still the seat belt. So please, buckle up—even if you drive a Mercedes-Benz. For more information about Mercedes-Benz safety, call 1-800-243-9292 or visit your authorized Mercedes-Benz dealer. Some of the safety features depicted vary from model to model.



ENGINEERED LIKE NO OTHER CAR IN THE WORLD



We'd like to uncover a hidden natural resource.

Did you know that the empty plastic soft drink bottles you throw away every day can be transformed into carpet yarn or automotive parts or fiberfill for ski parkas?

That used glass bottles and aluminum cans can be transformed into new ones?

And that yesterday's newspaper can be transformed into tomorrow's?

It all happens because of recycling. The trash we throw away is a "natural resource" that, with recycling, can be used to produce a multitude of new products.

Unfortunately, America recycles only 10% of its garbage, incinerates 10% and deposits a whopping 80% in landfills. As a result, we are having to cope with a monumental solid waste problem.

Our landfills are going-going-gone.

Americans throw away about 160 million tons of garbage a year. According to a recent study, plastics make up about 18% of the volume of solid waste in our landfills, paper and paperboard account for about 38%; metals, 14%; glass, 2%; and other wastes, 28%, all by volume.

As a result, in the past 10 years our country's landfills have decreased from about 18,500 to 6,000. In five years 2,000 more will close.

In their haste to find solutions, some local legislatures have proposed to ban plastics.

Unfortunately, a ban on plastics would do much harm and no good. We would lose all of the safety, health and convenience features of plastics, such as tamper-resistant closures and shatter-proof bottles.

Moreover, packaging would still be needed. A 1987 study showed what would happen if plastics were banned—the energy needed to produce the alternative packaging, its weight, its cost, and the volume of waste collected would all rise dramatically.

What to do?

At Amoco Chemical, we believe part of the answer to America's waste problem lies in recycling everything from glass to metals to paper to plastic.

Today, recycling is on the rise. There are now more than 1,000 curbside separation recycling programs across the country. Many are beginning to incorporate plastics.

Right now, almost 200 companies are recycling millions of used plastic containers into paint brush bristles, traffic signs, toys, floor tiles, wastebaskets and "plastic lumber" for decks and park benches.

Plastics are among the easiest materials to recycle. More than 150 million pounds, or 20% of all plastic soft drink bottles, were recycled in 1987.

How Amoco Chemical is helping.

Amoco Chemical is sponsoring a recycling program in New York demonstrating that used, polystyrene foam food service containers from schools and restaurants can be recycled into insulation board for commercial construction, cafeteria trays and home and office products.

We're participating in a consortium with other major plastics manufacturers involved in the construction of regional polystyrene recycling plants.

We're encouraging the start-up of new recycling efforts, helping to find better ways to collect and sort recyclables, and supporting efforts to create new markets for products made from recycled products.

At Amoco Chemical, we believe recycling can add years of life to our landfills while it transforms things that would ordinarily be thrown away into useful new products. We've only begun to uncover its benefits.

For a free copy of "Recycling. Do It Today For Tomorrow," call 1-800-727-0017. Or write Amoco Chemical, Recycling, 200 East Randolph Drive, Chicago, IL 60601.

Recycling. Do It Today For Tomorrow.



Amoco Chemical



WEEKLY BEER BUST IN CUPERTINO: ONE OF THE CARRYOVERS FROM THE CAREFREE DAYS OF APPLE'S YOUTH

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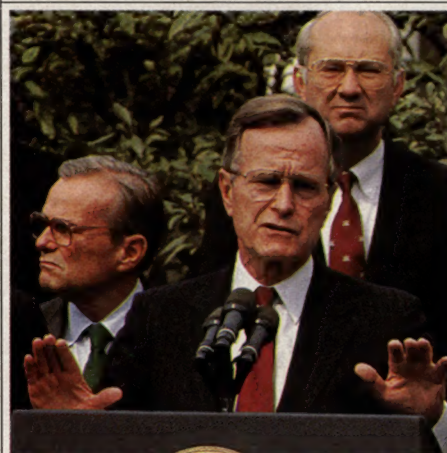
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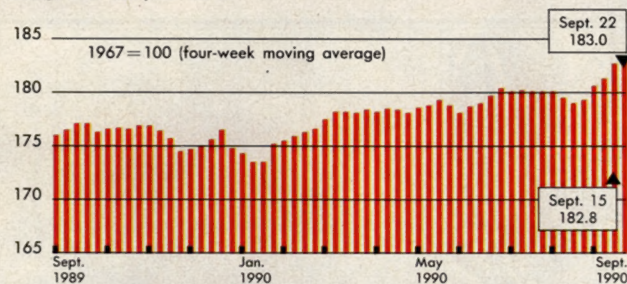
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BusinessWeek Index

PRODUCTION

Change from last week: 0.1%
Change from last year: 3.3%

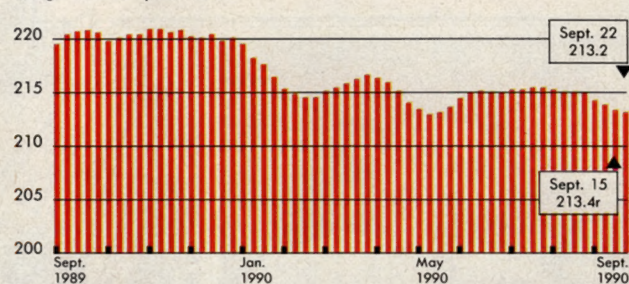


The production index rose slightly in the week ended Sept. 22. After seasonal adjustment, auto and truck production rose, as did output of lumber, coal, and paperboard. Production at electric utilities dropped steeply, while rail-freight traffic and paper output posted small declines. Steel production and crude-oil refining were unchanged. Before calculation of the four-week average, the index fell sharply to 181.2 from 184.4 in the previous week.

BW production index copyright 1990 by McGraw-Hill Inc.

LEADING

Change from last week: -0.1%
Change from last year: -3.5%



The leading index declined in the week ended Sept. 22, continuing its downward trend of the past year. Stock prices fell, and bond yields rose. Initial claims for unemployment insurance climbed higher, while real estate loans and the M2 money supply grew more slowly. On the plus side, business failures fell, and materials prices grew faster. Before calculation of the four-week average, the leading index was unchanged from the previous week, at 213.5.

Leading index copyright 1990 by Center for International Business Cycle Research

PRODUCTION INDICATORS

	Latest week	Week ago	% Change year ago
STEEL (9/29) thous. of net tons	1,878	1,883 #	5.1
AUTOS (9/29) units	137,288	148,232r #	-9.2
TRUCKS (9/29) units	83,750	86,770r #	7.7
ELECTRIC POWER (9/29) millions of kilowatt-hours	53,028	55,464 #	6.1
CRUDE-OIL REFINING (9/29) thous. of bbl./day	13,962	14,262 #	1.4
COAL (9/22) thous. of net tons	21,517 #	21,371	8.3
PAPERBOARD (9/22) thous. of tons	757.5 #	753.2r	3.7
PAPER (9/22) thous. of tons	752.0 #	750.0r	1.6
LUMBER (9/22) millions of ft.	495.9 #	461.6	-7.2
RAIL FREIGHT (9/22) billions of ton-miles	21.3 #	21.5	7.6

Sources: American Iron & Steel Inst., Ward's Automotive Reports, Edison Electric Inst., American Petroleum Inst., Energy Dept., American Paper Inst., WWPA¹, SFPA², Association of American Railroads.

FOREIGN EXCHANGE

	Latest week	Week ago	Year ago
JAPANESE YEN (10/3)	137	137	143
GERMAN MARK (10/3)	1.55	1.57	1.89
BRITISH POUND (10/3)	1.89	1.87	1.60
FRENCH FRANC (10/3)	5.19	5.26	6.41
CANADIAN DOLLAR (10/3)	1.15	1.15	1.18
SWISS FRANC (10/3)	1.28	1.31	1.64
MEXICAN PESO (10/3) ³	2,895	2,894	2,578

Sources: Major New York banks. Currencies expressed in units per U. S. dollar, except for British pound expressed in dollars.

PRICES

	Latest week	Week ago	% Change year ago
GOLD (10/3) \$/troy oz.	389.400	402.700	6.4
STEEL SCRAP (10/2) #1 heavy, \$/ton	110.50	115.50	6.3
FOODSTUFFS (10/1) index, 1967=100	213.9	217.7	-0.1
COPPER (9/29) ¢/lb.	131.7	133.4	-4.0
ALUMINUM (9/29) ¢/lb.	88.5	93.5	11.6
WHEAT (9/29) #2 hard, \$/bu.	2.85	2.82	-31.7
COTTON (9/29) strict low middling 1-1/16 in., ¢/lb.	69.79	70.84	2.7

Sources: London Wed. final setting, Chicago mkt., Commodity Research Bureau, Metals Week, Kansas City mkt., Memphis mkt.

Raw data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment.
1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

LEADING INDICATORS

	Latest week	Week ago	% Change year ago
STOCK PRICES (9/28) S&P 500	304.83	315.15	-12.0
CORPORATE BOND YIELD, Aaa (9/28)	9.63%	9.51%	6.6
INDUSTRIAL MATERIALS PRICES (9/28)	108.3	107.7	1.8
BUSINESS FAILURES (9/21)	296	316r	26.5
REAL ESTATE LOANS (9/19) billions	\$381.1	\$380.6	9.4
MONEY SUPPLY, M2 (9/17) billions	\$3,320.7	\$3,317.7r	5.3
INITIAL CLAIMS, UNEMPLOYMENT (9/15) thous.	403	382	26.3

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1980=100), Dun & Bradstreet (failures of large companies), Federal Reserve Board, Labor Dept. CIBCR seasonally adjusts data on business failures and real estate loans.

MONTHLY ECONOMIC INDICATORS

	Latest month	Month ago	% Change year ago
MANUFACTURERS' INVENTORIES (Aug.) billions	\$373.9	\$373.3	0.7
MANUFACTURING SHIPMENTS (Aug.) billions	\$245.9	\$237.8r	3.2
NEW HOME SALES (Aug.) annual rate, thous.	550	558r	-23.5
12 LEADING INDICATORS COMPOSITE (Aug.) index	144.2	146.0r	-0.4

Sources: Commerce Dept.

MONETARY INDICATORS

	Latest week	Week ago	% Change year ago
MONEY SUPPLY, M1 (9/17)	\$820.7	\$820.7r	5.2
BANKS' BUSINESS LOANS (9/19)	318.4	317.3r	-0.3
FREE RESERVES (9/19)	81r	277r	-90.7
NONFINANCIAL COMMERCIAL PAPER (9/19)	155.1	148.8	19.1

Sources: Federal Reserve Board (in billions, except for free reserves, which are expressed for a two-week period in millions).

MONEY MARKET RATES

	Latest week	Week ago	Year ago
FEDERAL FUNDS (10/2)	8.32%	8.35%	9.18%
PRIME (10/3)	10.00	10.00	10.50
COMMERCIAL PAPER 3-MONTH (10/2)	7.95	8.14	8.83
CERTIFICATES OF DEPOSIT 3-MONTH (10/3)	8.03	8.30	8.91
EURODOLLAR 3-MONTH (9/26)	8.28	8.09	8.86

Sources: Federal Reserve Board, First Boston

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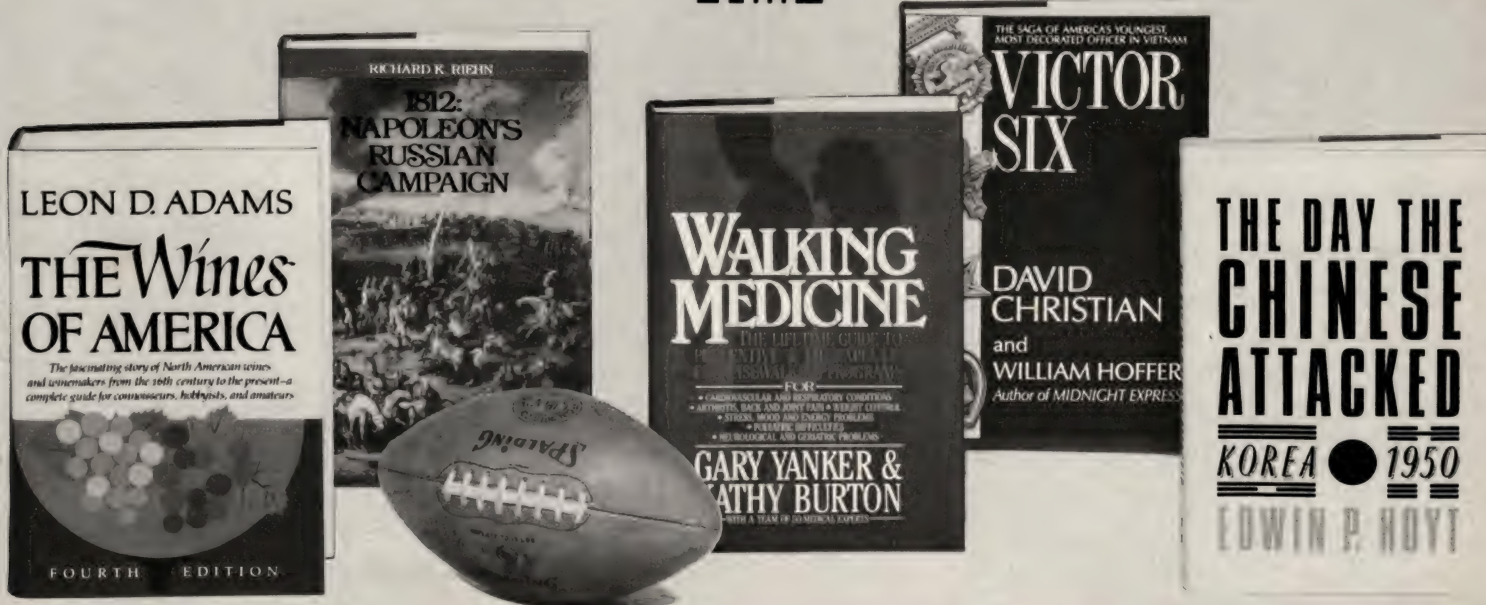
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TO DIVVY UP DISTRICTS, WHY DEPEND ON SEX AND RACE?

Your article "Money, power, and numbers: A firestorm over the census" (Washington Outlook, Sept. 17) says of the U.S. census: "One idea is to ask all citizens for only the minimum information needed for reapportionment—age, sex, and race." Why are sex and race needed for reapportionment?

Frederick M. Uleman
Tokyo

The suggestion for a stripped-down census count illustrates a misconception of what information really is required to meet the constitutional mandate. What possible reason is there to ask citizens their sex and race to produce the minimum information needed for reapportionment?

As for businesses that rely on pinpoint marketing information provided by the census, let them howl away. If they need such information, let them pay for their own marketing surveys instead of relying on taxpayers' generosity.

Don Ringler, General Partner
Creative Media Services
Watervliet, Mich.

Editor's note: Information about sex is not required by law. The 1965 Voting Rights Act does demand that the racial composition of a district be considered in reapportionment to enhance minority representation.

WHEN FEMALE BOSSES AREN'T WOMAN-FRIENDLY

Regarding Lilly Hirsch's letter ("What really makes a company 'woman-friendly,'" Readers Report, Sept. 17), she states: "The worst companies for women... fan the resentment some women have toward more successful or able women." The main thing that fans resentment is the attitude of many female executives toward women on the lower rungs of the corporate structure—clerks, administrative assistants, and secretaries. I have been on the receiving end of more rudeness, condescension, and patronizing putdowns from female

executives than I ever have from any of my male bosses and co-workers. With one exception (and I've been working since 1954), my bosses have all been encouraging and supportive. The boss who, on the surface, was the most chauvinistic was the one who encouraged me to take advantage of the company's tuition-refund program, which enabled me to go to college and get my degree.

As someone once said, if women want to act like men, fine—but why can't they act like nice men?

Joan L. Byrne, Assistant Treasurer
Griggs & Santow Inc.
New York

WARS AND RUMORS OF WARS DIDN'T HURT MAGGIE

The "year of the woman"? Well, maybe" Government, Oct. 1) quotes Celine Lake as saying, "The worst thing that could happen to a woman candidate is a military crisis."

Perhaps she would like to study the popularity ratings of our own Margaret Thatcher following the Falklands War, and more recently, the gulf crisis.

I wonder if this suggests something about British men or American women?
Peter Faulkner
London

MAYBE THE WEAPONS LABS ARE JUST THE RIGHT SIZE

I do not believe that you recognize the tremendous changes occurring at the Energy Dept. defense laboratories ("It's time to shrink the weapons labs," Editorials, Sept. 17).

The technology transfer bills enacted in 1980 and 1986 that govern most federal tech-transfer activities specifically excluded the weapons labs from participating, primarily because such transfers were regarded as a potential security problem. It was not until Congress passed the National Competitiveness Technology Transfer Act of 1989 that technology transfer became a core mission of the Energy Dept.'s defense labs—and for the first time, effective mechanisms were provided for transferring technology to the private sector.

At a time when the overlap between

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critical defense and commercial technologies is rapidly increasing, the weapons labs should not be shunted off into an ever narrower military mission. Instead, the labs' work in dual-use technology should be used to bolster our economic competitiveness and meet our environmental and educational challenges.

Senator Jeff Bingaman
(D-N. M.)
Washington

The Energy Dept.'s national laboratories are proving to be a treasure that may help U.S. industry remain technically strong in global competition.

A case in point is the recently discovered field of high-temperature superconductivity that has spawned intensive research and development activity in industrialized countries, particularly Japan. This poses a crucial test of America's ability to demonstrate technical and industrial leadership.

Responding to this challenge, Energy designated three of its national laboratories—Los Alamos, Oak Ridge, and Argonne—as Superconductivity Pilot Centers. They were encouraged to forge new links with industry and provide access to their specialized equipment and highly skilled scientists. Some 35 companies responded, and more than two-

thirds report that their collaborative programs are meeting or exceeding expectations. Du Pont is involved with all three of these labs.

The pilot center program is proving that technology transfer can work, that cultural change is taking place, and that government-industry collaboration can help keep the U.S. competitive.

Edward J. Mead, Du Pont Co.
Wilmington, Del.

Editor's note: Mead is chairman of the eight-member Industrial Overview Committee that evaluates Energy pilot center programs.

A JAPANESE ANSWER TO AMERICA'S PRAYERS?

Your highly skilled description of "Mighty Mitsubishi" answers essential questions as to why America is an inviting turf for Japanese cartels ("Mighty Mitsubishi is on the move," Cover Story, Sept. 24).

The *keiretsu* system is coming into the life of America. The prayers for a better America by Presidents Carter, Reagan, and Bush have been answered by the gods from Tokyo.

Stuart G. Crane
Yardley, Pa.

ANOTHER EASIER WAY TO GET RID OF GALLSTONES

Your article "Romancing the gallstone" (Science & Technology, Sept. 3) failed to include another gallstone treatment that is currently being prescribed by thousands of physicians nationwide. This oral medication is Actigall (ursodiol), which has been available since October, 1988. For those symptomatic gallstone patients who can't or won't have surgery, Actigall may dissolve cholesterol gallstones less than 20mm in diameter. Complete gallstone dissolution may not occur in all patients.

Traditional surgery requires a four-to-six-week recuperation time, and laparoscopic cholecystectomy four to seven days. Both types of surgeries are not without risk.

Arthur Emmett, M. D.
Senior Vice-President
Medical & Public Affairs
CIBA-GEIGY Corp.
Summit, N. J.

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THE AGE OF UNREASON

By Charles Handy

Harvard Business School Press • 278pp • \$18.95

'UPSIDE-DOWN THINKING' FOR A TOPSY-TURVY WORLD

Look around you. Your company is shrinking, producing more each year with fewer employees. There's a phone in your car and a fax machine in the study at home. Your spouse pursues a career three days a week. As for you, well, it's not clear just what you'll be doing, or how, in five years.

It's not completely clear to Charles Handy, either. But he does know this: "Things are not going to go on working as they have been working, whether we like it or not." We have entered an era of wrenching, disjunctive change—the Age of Unreason—and "the status quo will no longer be the best way forward."

Handy, an Irish academic, BBC commentator, and student of organizational questions, has produced an eloquent handbook for contemplating, coping with, and capitalizing on this change. It

is an oddly gripping exploration of what he calls "upside-down thinking"—thinking that challenges the established order. Applying this perspective, Handy comes up with a fascinating, sometimes unsettling, vision of the future.

In business, Handy detects the emergence of a tripartite "shamrock" corporation. The first leaf is the corporation's core—populated by talented, dedicated professionals who work long hours for high pay. The core, though important, is expensive. So it keeps shrinking, as organizations farm work out to independent contractors—the second leaf—and hire more part-time workers—the third.

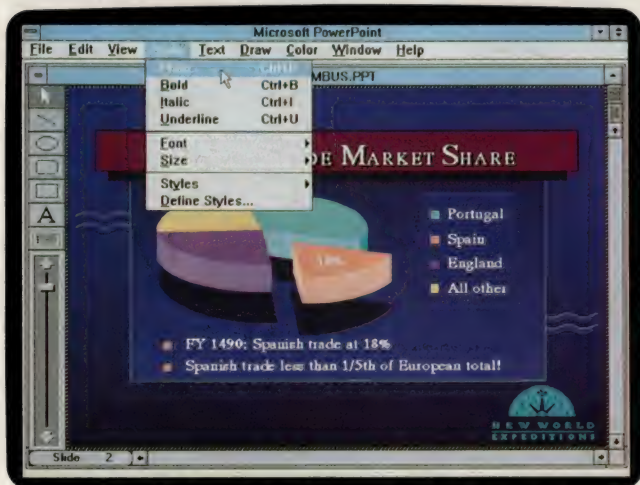
Brutally tough global competition forces this change. Technology makes it possible. Personal computers and telephones let us work pretty much where we want. A prototypical shamrock, says

Handy, is Britain's little-known but fast-growing F. I. Group, which writes computer programs on contract. Seventy percent of its 1,100 workers, most of them self-employed contractors, toil at home or at local work centers and deliver their output electronically to a small headquarters.

In the shamrock corporation, centralized decision-making is out, replaced by a willingness to give autonomy to talented employees in dispersed locations. So most jobs will change fundamentally. Handy likens the evolving job to an "inverted doughnut": Only the center, involving work strictly defined by the organization, is solid. That core is growing smaller. The complexity of business today requires that the space around the center, where workers have freedom and responsibility, become ever broader. Teachers and social workers already work in this space, determining for themselves how to spend their time. Other professions will follow.

For the employee, in fact, everything will change. A career will encompass just half the time it did a generation ago. Some of us will work longer hours for fewer years, leaving the core at age 45 or 50. Older workers, experienced but

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losing energy, will find part-time or consulting roles. But most people will never work in the core. From the outset, they may work part time at one company, consult for another, and spend one day a week volunteering. Or they may intersperse work with education. People will have "work portfolios" that change from year to year and age to age.

This lack of structure has its allure, but in many ways, Handy's vision is terrifying. The steady path of promotion in a hierarchical organization will be a relic, supplanted by a "horizontal fast track" that provides valued employees an array of work experiences.

The consequences could be wide-ranging. More people working at home could mean less-congested roads, depressed car sales, and fewer jobs for office cleaners. More importantly, as Handy writes, "Half the people working twice as hard, while the other half have not enough to do, is a worrying prospect." Indeed, he broods over how societal divisions in such a



world would affect the poor and elderly.

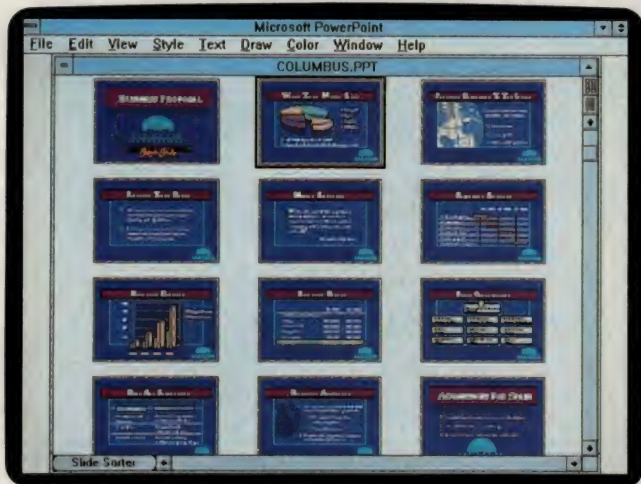
Handy tackles these concerns with more upside-down thinking. To improve education, he proposes "shamrock schools" offering a core curriculum plus specialized classes taught by outside contractors. He advocates regular government stipends, scaled to other in-

come, for all citizens, and replacing income taxes with a higher, more easily administered, sales tax. That's not so farfetched: A sales tax cushioned by stipends need not shortchange the poor. And as Handy admits, his ideas represent less a concrete prospectus than a spark to get us thinking.

They did that for me. Although lessons on organizational management involving "shamrocks" and "doughnuts" may sound off-putting, they're not. Handy's stylish prose, salted with anecdotes and the odd British-ism, is captivating. Since reading his book, I've found myself considering my own career, and responding to friends' concerns about theirs, using Handy's concepts. *The Age of Unreason*, says Handy, is written "for those who live in the midst of change and do not notice it or want it." Which is most of us, really: We see increasing evidence of a world out of whack—growing hunger, environmental crises, economic dislocation—yet we resist contemplating solutions that

TIM BOWER

tions into your own hands.

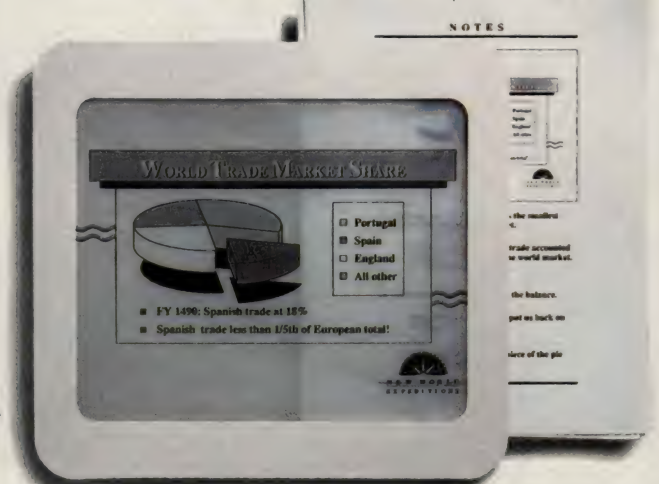


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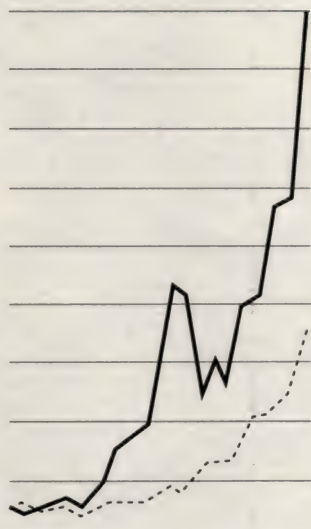
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BY KEITH H. HAMMONDS

Boston Bureau Manager Hammonds is trying to fit more skiing and exotic travel into his work portfolio.

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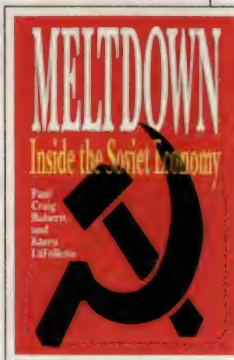
By Paul Craig Roberts and Karen LaFollette
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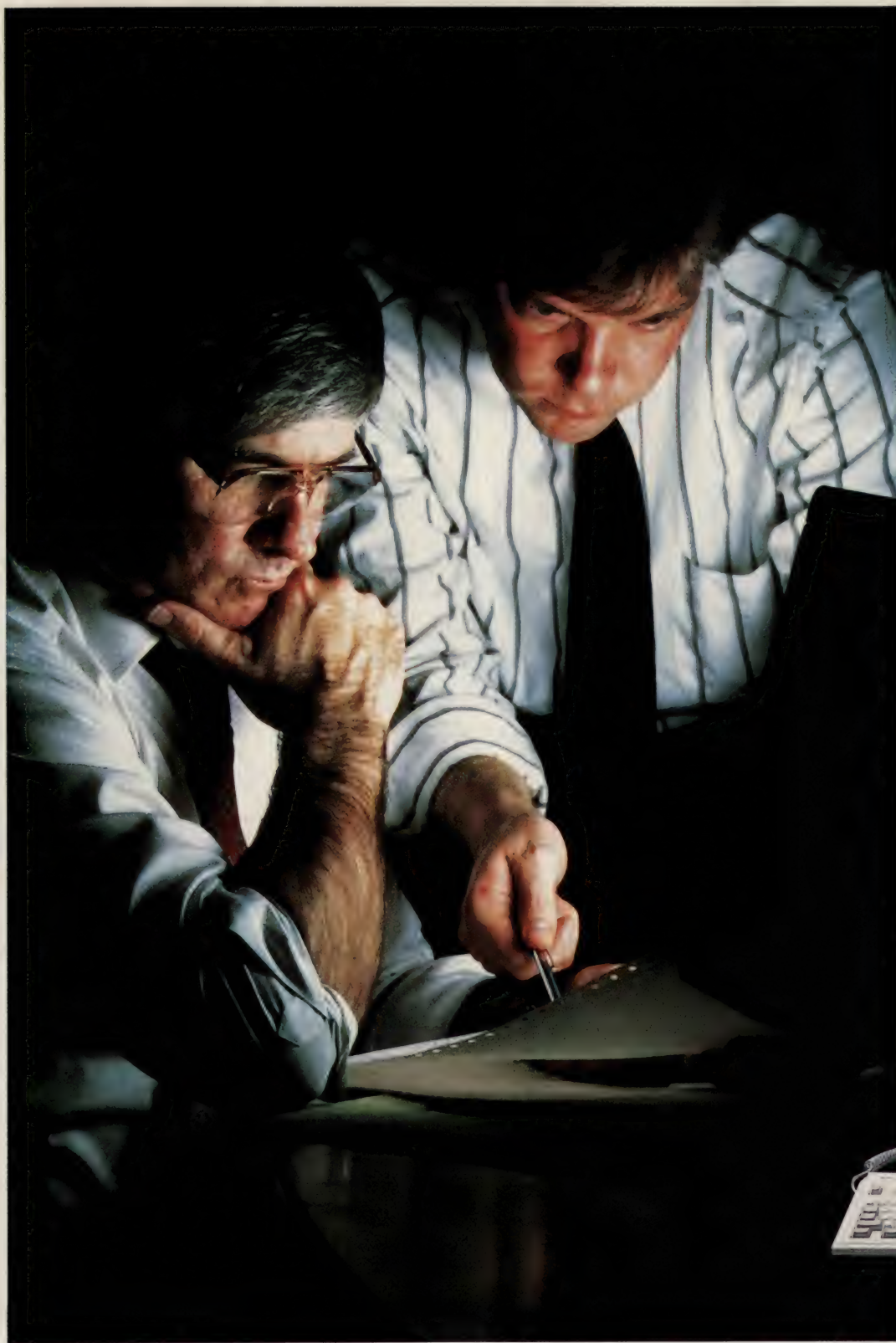
To be proven right in your own time is sweet. "The result of decades of efforts at central planning has been to establish that for a modern economy, there is no viable alternative to the market," wrote Paul Craig Roberts in 1971's *Alienation and the Soviet Economy*. Then, few agreed: The Soviet Union's manufacturing output was supposedly rising almost 9% annually, and its rapid industrialization was envied by underdeveloped countries. Now, it's clear those numbers involved more hot air than cold steel.

This fall, publisher Holmes & Meier will underscore Roberts' prescience by issuing a revised edition of *Alienation*. In addition, BUSINESS WEEK columnist Roberts, with Karen LaFollette, explores the same theme in a new book, *Meltdown: Inside the Soviet Economy*. Drawing mainly on recent Soviet press items, they cite countless examples of the Soviet economy's irrationality—factories that don't work, products no one wants, a lack of housing and medical care. The diet of America's urban homeless, they say, compares favorably with the basic Soviet diet.

The authors emphasize that Soviet managers act in their own interests, not society's or even the party's. Central planning provides perverse incentives: Factories can get bonuses for exceeding quotas, which induces drugmakers, for example, to produce "medicine" that's little more than sugar or salt and water.

Roberts and LaFollette see the Soviet system as a source of moral breakdown. Bribes and black markets, they write, are the norm. Used to stealing from state companies, people feel free to steal from private ones, which complicates the move to free markets. But the authors conclude optimistically that the party's consent to its demise shows that "good will can prevail over material interest."





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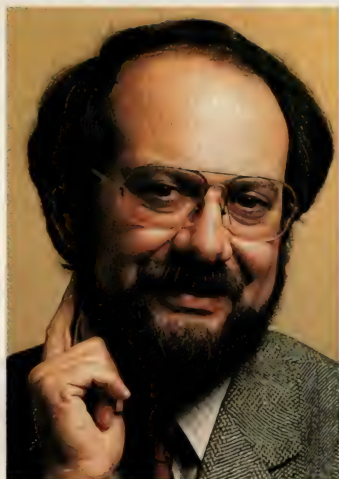


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ONE BIG, HAPPY GLOBAL ECONOMY? NOT YET, FRIEND

BY ROBERT KUTTNER



Although Honda is busy working in Ohio and IBM is in Japan, companies around the world still operate with their national interests in mind. America take note: The vision of the stateless corporation remains just that—a vision

As the economy becomes a global one, how do we define a national interest? Seemingly, the economy is so globalized that the national identity of companies no longer matters. Kenichi Ohmae argues in his latest book, *The Borderless World*, that in this new era, "trade statistics are meaningless." Ohmae asks rhetorically: "Is IBM Japan an American company? . . . Or what about Honda's operation in Ohio?" Ohmae's views lead to a fairly conservative set of conclusions: Don't worry about Japan's mercantilism, and "... throw the bureaucrats out."

In a *Harvard Business Review* article titled "Who is Us?," Robert Reich takes the same insight in a more liberal direction. Americans used to scoff at "What's good for General Motors is good for the country." But by wrapping the national interest in the interest of a U.S.-based corporation, some advocates of "national competitiveness" fall into precisely the same trap. "Who is us?" Reich asks. "Is it IBM, Motorola, Whirlpool, and General Motors? Or is it Sony, Thomson, Philips, and Honda?" Reich points out that U.S. corporations often produce overseas, while foreign corporations often produce in the U.S. Texas Instruments does most of its production abroad, while the biggest "American" manufacturers of TVs are Philips (Dutch) and Thomson (French).

Reich concludes that "American competitiveness can best be defined as the capacity of Americans to add value to the world economy" regardless of the nationality of the company that employs them. "The interests of American-owned companies may or may not coincide with those of the American people." His policy recommendations call for increased investment in education, training, research, and infrastructure, so that America becomes "a good place for any global corporation seeking talented workers to set up shop."

LOOK HOMEWARD. These arguments are extremely seductive and irrefutable as far as they go. However, Ohmae's picture of a seamless, stateless global economy leaves out a few awkward details. In reality, many governments do precisely what Ohmae and Reich deplore. Namely, they identify the national interest with the self-interest of home-based corporations. The American economist Mordechai Kreinin, in a study of 62 Japanese, European, and U.S. corporations doing business in Australia, found that all of the U.S. subsidiaries and most of the European ones purchased capital goods from suppliers all over the world by putting out bids. Most of the Japanese companies bought only Japanese. Although Ohmae's book is full of exam-

ples of U.S.-owned companies happily doing business in Japan, he glosses over the fact that Japanese mercantilism often demands technology transfer, licensing, local content, and joint-venture deals favorable to the Japanese as a precondition for entering Japan at all. It is no accident that most goods sold by "American" companies operating in Japan are made in Japan. That occurred not because the U.S. parent company necessarily wanted it that way, but because the Japanese insisted on it.

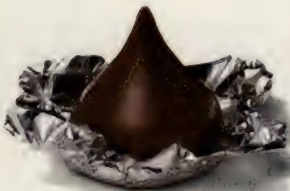
The picture of stateless, globalized corporations, with operations, shareholders, and managers all over the world, largely indifferent to location except on grounds of economic efficiency, is in some sense emergent—but premature. Most Japanese companies—and the Ministry of International Trade & Industry—still think in terms of benefiting Japan. Alain Gomez, the aggressive CEO of Thomson, indeed has far-flung global operations, but he thinks in terms of what's good for France. The implication of the borderless world/stateless corporation view is that it doesn't matter if U.S.-based companies are driven out by other people's mercantilism as long as other people invest here. This is, of course, exactly the point of Ohmae's soothing reassurances.

SKILLS NEEDED. As Andrew Grove, CEO of Intel, points out, Japanese companies design ultrahigh-technology products that can be assembled largely by uneducated young Asian women. The heart of the operation, however, stays in Japan—manufacturing expertise, financial power, scientific knowledge, engineering and marketing talent, and the flow of profits to capitalize the next round of innovation. If U.S.-based high-technology companies are simply driven out of business by the mercantilism of other nations, we will gradually assume the position of those low-wage East Asian women.

Reich has framed the dilemma aptly: how to define the national interest in a newly globalized economy. American prosperity will depend primarily on the skills of its workers and managers quite apart from the nominal flag of its corporations. And he's right that our allegiance to a GM or a TI should be conditional rather than merely patriotic—just as our embrace of the Hondas and the Thomsons should be based on what they bring to America. Yet it is hard to imagine a strong U.S. economy without U.S.-owned and -managed companies. To that end, we need a more realistic policy on trade, technology transfer, and market access. If "they" keep playing by different, more nationalistic, rules to the detriment of U.S.-owned companies, "we" will soon be out of business. ■

ROBERT KUTTNER IS ECONOMICS
CORRESPONDENT FOR THE NEW REPUBLIC
AND AUTHOR OF THE LIFE OF THE PARTY

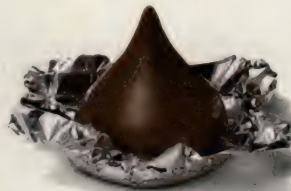
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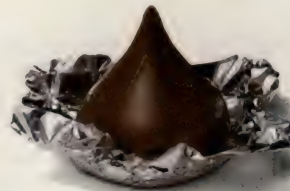
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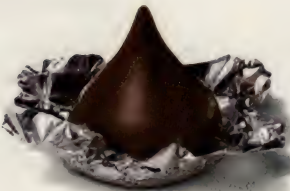
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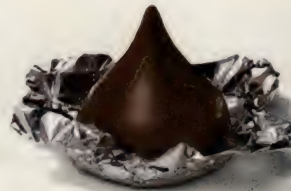
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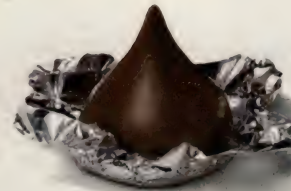
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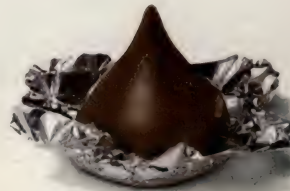
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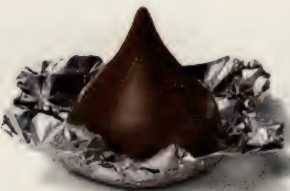
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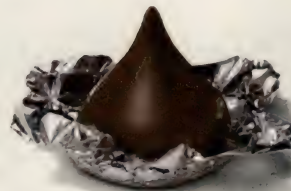
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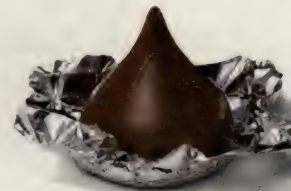
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DID SOMEONE
SAY SWEETS?

Economic Trends

BY GENE KORETZ

THIS TIME, CANADA GOT THE BLUES BEFORE THE U.S.

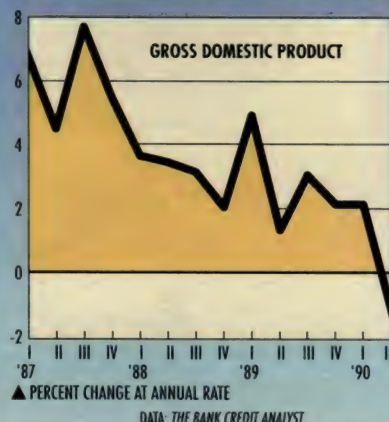
When the U.S. economy sneezes, the Canadian economy catches pneumonia. So goes an old cliché, and in light of the close linkage between the two economies and the mammoth size of the U.S. economy, it's hardly surprising that it has almost invariably proved to be true—until now. "The Canadian economy slipped into a homegrown recession last quarter, reversing the usual relationship in which the U.S. leads and Canada follows," observes economist

ness bankruptcies are soaring, and unemployment has climbed by 0.8% in just two months, to 8.3% in August. Although higher oil prices will help Canada's energy exports, their main effect will be to boost inflation and cut into disposable income.

Now, Canada's problems should start affecting the weakening U.S. economy. "Thus far," notes economist Lawrence Krohn of Shearson Lehman Brothers Inc., "the U.S. has been largely insulated from Canada's economic woes because high interest rates strengthened the Canadian dollar and thus increased the competitiveness of U.S. products in Canadian markets." But the decline in Canada's domestic demand will soon start to outweigh this price effect, he predicts. And since Canada is Uncle Sam's most important customer, accounting for more than 22% of U.S. exports, that will only increase the odds of a U.S. recession.

That's not the end of the story. Barnes points out that 75% of Canadian exports go to the U.S. "So if Canada's problems help tip the U.S. into recession, its own downturn will inevitably be that much more severe."

CANADA'S ECONOMY HAS SLIPPED INTO RECESSION



Martin Barnes of the Montreal-based *Bank Credit Analyst*.

The major cause of the Canadian downturn has been the determination of the nation's monetary authorities to cool down an overheated economy and tame inflationary expectations. The Bank of Canada has been stepping on the monetary brakes since the beginning of last year, pushing short-term interest rates higher than 13% before easing slightly recently. By the second quarter of this year, Canada's economy was declining at a 1.6% annual rate (chart), and observers see few indications that the contraction is ending.

For one thing, the second-quarter decline was broad-based, involving all the major components of domestic demand. Machinery and equipment spending fell at a 17.9% annual rate, residential construction plummeted at a 15% pace, and consumption declined at a 1.5% annual clip—the first such drop since the 1982 recession. Meanwhile, the government's composite index of leading indicators has fallen for six months in a row, busi-

IS AN 'ANGLO-SAXON' RECESSION ON THE HORIZON?

Barring an outbreak of war in the Middle East that blasts oil prices into the stratosphere, most economists reject the notion that the 1990 oil price shock could result in a global recession such as the one that occurred in the mid-1970s. The world economy is less dependent on oil than it was in past episodes, they note, and current economic cycles are more out of sync. But the chances of what some observers term an "Anglo-Saxon" recession seem to be increasing.

For one thing, Canada is not the only English-speaking nation (officially, of course, it's bilingual) that is apparently already afflicted by recession. The Australian economy also contracted in the second quarter of this year—at a 3.6% annual rate. Economists at Salomon Brothers Inc. point out that domestic demand posted its sharpest quarterly drop in 15 years.

Meanwhile, the consensus among American economists is that the U.S. will enter a recession within the next six months—if one has not already begun. And many observers believe that recessionary risks are rising in Britain, where domestic demand is wilting under the impact of a yearlong siege of 15% interest rates.

REAL ESTATE COULD DRAG MANY BANKS INTO A SINKHOLE . . .

Don't assume that the ravaged housing and commercial property sectors cannot wreak further damage on the economy. Although construction activity in both areas is so depressed that it seems unlikely to decline much further, a drop in asset values caused by a severe economic downturn could still rock the financial system.

Indeed, economist Edward E. Yardeni of Prudential-Bache Securities Inc. points out that commercial banks held \$601 billion in commercial and industrial loans and \$515 billion in real estate loans at the end of 1986. By yearend 1989, however, C&I loans had only risen to \$618 billion, while real estate loans had soared to \$762 billion. "Real estate loans accounted for an astonishing 87% of the growth in the banks' loan portfolios."

Once bitten, twice shy. At best, the hangover suffered by commercial banks and savings and loan associations after their recent lending binge suggests that falling interest rates and easier money are unlikely to foster more than a modest recovery in housing and commercial construction for a long time to come. At worst, it could signal greater trials ahead for the banking system if real estate prices erode much further.

... AND LENDERS ARE FEELING SIMILAR TREMORS IN JAPAN

Are Japanese banks headed toward a real estate crisis of their own? The chances seem slim, given Tokyo's penchant for damage control at the first sign of trouble. Still, economist Toru Nakamura of Nakagama & Wallace Inc. notes that the huge runup in real estate prices in recent years is ripe for deflation. And the Tokyo stock-market crash has undoubtedly hurt those speculators who collateralized bank loans with real estate holdings. Thus, the stock market plunge and the sharp rise in Japanese interest rates suggest that land prices may also start to drop as speculation is curtailed.

If such a drop turned into a bust, the big banks would obviously take a hit. But the biggest losers, says Nakamura, would be Japan's numerous leasing and finance companies, which have been major players in the real estate investment and development boom. ■

THIS RECESSION IS LIKELY TO BE AROUND FOR A WHILE

Recession is the consensus forecast for the U.S. economy. The burning question now is: How bad? The latest data don't offer much solace, but chances are good that the downturn may turn out to be shallow by postwar standards. The bad news is that the pain may be drawn out over a long period of time.

The current suffering is easy enough to see. The data even suggest Federal Reserve Board Chairman Alan Greenspan's rigorous definition of recession: a "cumulative unwinding" of economic activity. Demand throughout the economy had already dried up in the second quarter. Then came the oil shock—the hammer blow that many economists had feared.

The latest numbers for August only continued the deluge of negative reports since the Mideast crisis. The leading indicators fell a steep 1.2%—the largest drop since the stock market crash in late 1987. Sales of new one-family houses were down, as was overall spending on private construction. And the Conference Board's index of help-wanted advertising fell to the lowest level in six years (chart).

SEVERAL SIGNS POINT TO A MILD DIP

What kind of downturn do these data presage? Recessions are typically characterized by three Ds—depth, dispersion, and duration. The lack of many traditional imbalances that have caused the economy to swing downward so sharply in the past should prevent the downturn from being deep and widespread (page 30).

Manufacturing, the sector that wields the most cyclical influence in the economy, is in better shape to weather a recession this time. To begin with, factory inventories are very low in relation to sales. In August, stock levels rose 0.2%, but shipments were up 3.4%. As a result, the ratio of inventories to sales fell to 1.52.

That's the lowest ratio in the expansion, and it is by far the lowest reading on record heading into a recession. That means a downturn will not cause the same number of layoffs and production cuts associated with efforts to rein in excessive stock levels during past recessions. Factories have already laid off 450,000 workers since January, 1989, in an effort to keep inventories in line and costs down.

Also, factories now export a record 20% of their output—40% for producers of capital goods. Export growth

is bound to slow as the oil shock hits around the world, but growth will continue, buoyed particularly by a cheaper U.S. dollar. And the need for U.S. companies to increase their international competitiveness is likely to limit cutbacks in capital spending.

Make no mistake, though: Manufacturing will be no help to the economy in coming months. The Purchasing Managers' Index, a composite of factory indicators compiled by the National Association of Purchasing Management, fell to 44.4% in September, from 47% in August (chart). When the index falls below 50%, it means the manufacturing sector is in a recession.

Last month's reading was the lowest in nearly eight years, and it suggests that the economy's August weakness extended into September. Indeed, the NAPM said that new orders among its members fell to their lowest level since the 1981-82 recession—a sign of further weakness to come in factory production and employment.

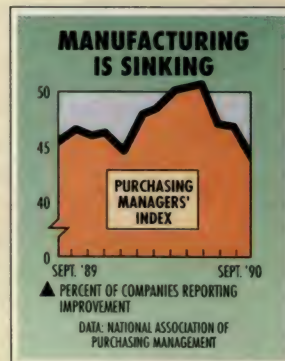
However, the purchasers reported that export orders continued to grow in September. And 88% of the companies said they had not changed their capital-spending plans as a result of the Mideast crisis.

BUILDING IS ALREADY CLOSE TO BOTTOM

Other factors will also limit the depth of the downturn. First, the foreign-trade deficit should continue to narrow. Exports will grow, if more slowly, but imports will fall, reflecting sagging U.S. demand. Because of the record share of domestic spending that imports now hold, foreign producers will absorb more of the weakness in demand than in past recessions.

In addition, construction has already fallen so far that it is probably closer to the bottom than it has been at the start of previous recessions. That's particularly true for housing. New-home sales fell 1.4% in August, to an annual rate of 550,000. That's 23.5% below the August, 1989, level. Housing starts have been in a steady downtrend since early 1986. Since then, they have posted a recession-size drop of nearly 43%.

But construction still has to fall a bit more. Building outlays have not yet reflected the decline in the value of new contracts during the past year. Contracts fell 3% in August, according to McGraw-Hill Inc.'s F. W. Dodge Group, pushing them 15.8% below their year-ago



Business Outlook

level. Yet construction outlays are still up 2% from last year. As existing projects are completed, there aren't many new ones to take their place. That means fewer outlays and fewer jobs in coming months.

The weakness was plain in August. Construction spending was unchanged at \$442.5 billion, but a surge in public building offset a 1.9% drop in private building. After adjusting for inflation, private construction spending fell to its lowest level in more than six years (chart). Real outlays for residential projects were off 1.2% in the month, while business construction fell 4.4%, including a sharp drop in industrial building.

HELP FROM THE FED MAY TAKE A WHILE...

But while the recession stands a good chance of being shallower than average, the economy's untraditional imbalances, mainly those related to excessive debt, will take a long time to set straight. Until then, the economy is likely to remain depressed. The average postwar recession has lasted about a year. A recession at least that long seems possible, particularly since economic policy doesn't seem to favor growth.

The new taxes and spending cuts contained in the Sept. 30 budget deal between the White House and Congress are an instant dose of fiscal restraint. But while the Fed is likely to ease monetary policy, as it has all but promised in the wake of a "credible and substantial" budget package, it could take six months to a year for the stimulative effect of easier money to kick in.

And unless the economy starts to come apart at the seams, any easing in coming months is not likely to be aggressive. That's because the Fed is still concerned about the inflationary consequences of the oil shock. Since the central bank has put off easing for so long, it is getting a late start on an economic recovery.

The fiscal squeeze is not only at the federal level. In the second quarter, the operating budgets of state and local governments—excluding social insurance—posted

the largest nationwide deficit on record. Higher taxes and less spending at the state and local level will be a drag on the economy, too.

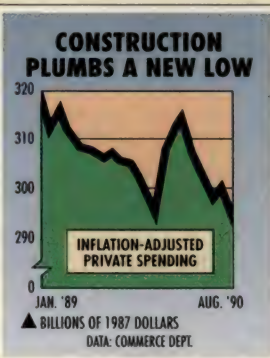
... AND DEBT COULD DRAG OUT THE PAIN

Debt also promises to stretch out the recession. Many corporations are leveraged to the hilt at a time when profits are falling. Earnings are sure to dip further in a recession, but interest costs will remain enormous. Keeping costs under control will mean trimming jobs, and consumers are already hurting.

In the second quarter, yearly growth in real consumer spending had fallen to only 1.3%. It has rarely slowed that much even in the depths of many postwar recessions. And consumers' large debt burdens will weigh heavily for some time. The second-quarter ratio of total consumer debt to disposable income was more than 20% higher than at the start of the 1981-82 recession. That ratio will rise even more as incomes weaken further.

It's no wonder that consumer attitudes are at such a low ebb. In September, the University of Michigan's index of consumer sentiment fell to the lowest level in 7½ years. Moreover, optimism seems to be waning in virtually all geographic regions. Even if confidence builds back up next year, consumers' debt problems may prevent a strong rebound in spending.

The second big question mark, of course, is the severity of the strain that the high leverage of the 1980s has placed on the financial system. Banks and many corporations are already getting wobbly, and the longer the recession continues, the more the pressures on them will grow. That just might be the element that turns a long and shallow recession into one that's long and deep.



THE WEEK AHEAD

INITIAL UNEMPLOYMENT CLAIMS

Thursday, Oct. 11, 8:30 a.m.

First-time claims for unemployment insurance for the week ended Sept. 29 are likely to be reported at about 395,000. Claims topped the 400,000 mark in the post-Labor Day week ended Sept. 15. A big rise in the week following a holiday is typical, but claims seem to be trending higher. The four-week average, at 384,000 in the most recent week, is the highest in four years, suggesting that the unemployment rate will be moving up this fall. New claims will take on increasing importance in the months ahead, mainly because they are a leading indicator of the economy. In addition, claims are a timely indicator, be-

cause they are reported weekly. Levels greater than 400,000 have usually preceded recessions.

RETAIL SALES

Friday, Oct. 12, 8:30 a.m.

Retail sales probably posted a modest 0.6% gain in September, according to a survey of economists by McGraw-Hill Inc.'s MMS International, following a 0.6% decline in August. Higher auto sales, helped by incentives from dealers, were a bright spot. But excluding cars, the analysts expect a rise of only 0.2%. Moreover, the increase will be inflated by higher sales at gasoline stations—the result of higher prices. Adjusted for inflation, real retail sales should be down. They're already 2% below last year.

PRODUCER PRICE INDEX

Friday, Oct. 12, 8:30 a.m.

Producer prices for finished goods in September likely jumped by 1.2%, according to the MMS survey. The steep rise reflects the second month of sharply higher energy prices following Iraq's invasion of Kuwait on Aug. 2. Prices of finished goods had risen 1.3% in August. However, the core rate of finished-goods inflation, which excludes the volatile energy and food sectors, is likely to be up only 0.4%, according to the economists, following a modest 0.3% rise in August. Other than energy, inflation pressures in the economy's goods-producing sector continue to moderate, reflecting the general weakness in manufacturing.

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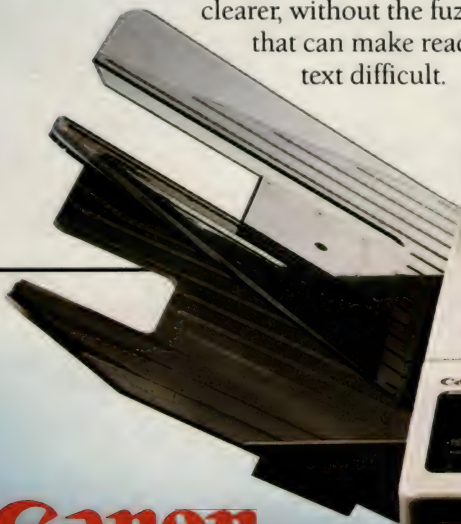
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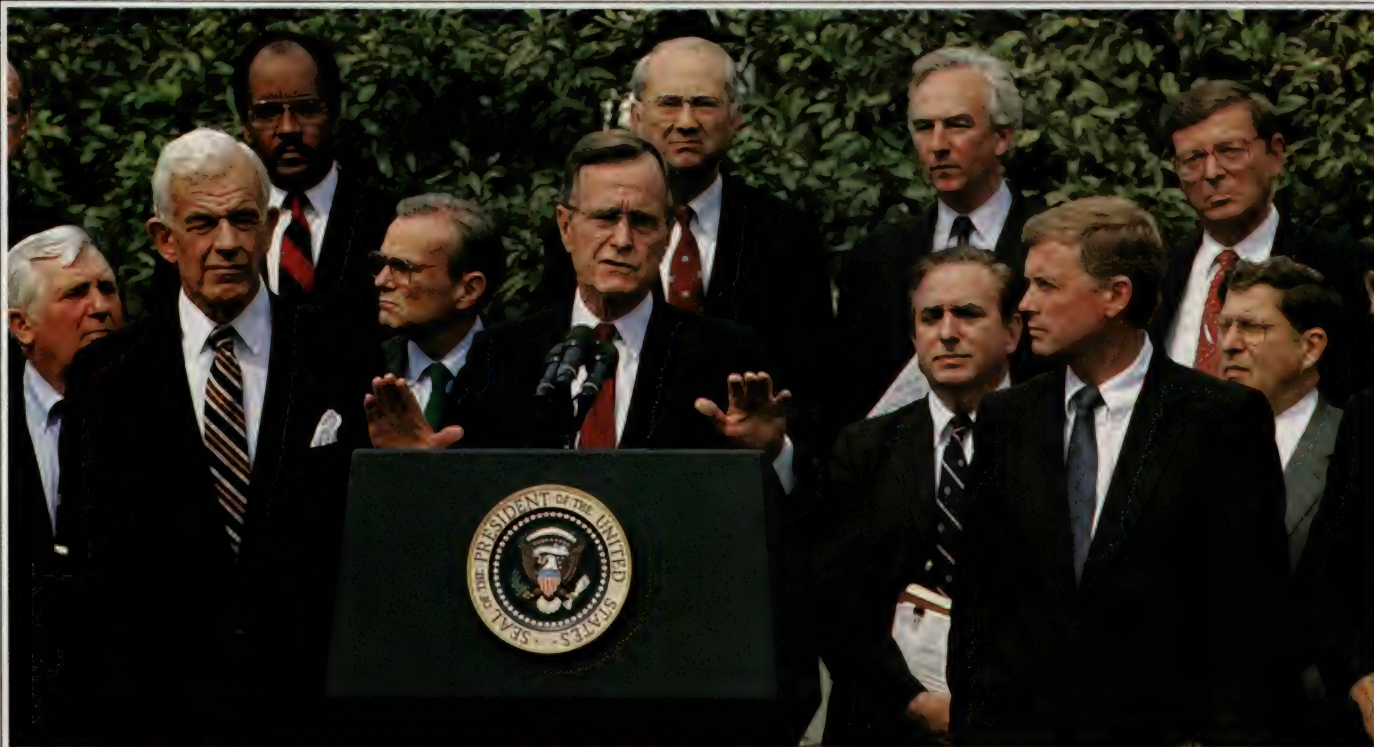
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BUSH, SURROUNDED BY STAFF AND CONGRESSIONAL LEADERS, MEETS THE PRESS ON THE BUDGET: A LOT OF ARMS LEFT TO TWIST

OCTOBER 15, 1990

THE LAST BEST CHANCE?

THE BUDGET PLAN WILL CUT THE DEFICIT—BUT NOT AS MUCH AS ADVERTISED

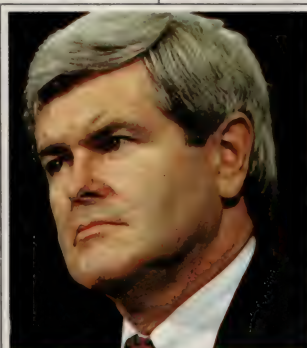
As Dr. Samuel Johnson once said of a dog walking on its hind legs: "It is not done well; but you are surprised to find it done at all." The same can probably be said for the budget deal hammered out by President Bush and exhausted congressional leaders on Sept. 30. After nearly two years of haggling, White House and Capitol Hill negotiators finally reached agreement on a multiyear plan to attack the deficit.

While the agreement falls far short of the Deal of the Century that Budget Director Richard G. Darman wished for, the pact at least begins to tame the deficit, which once again is soaring. The accord is "the last best chance to get this deficit under control," Bush says. "The major benefit will be a more vigorous economy." Maybe. And only if Bush can sell the plan to a hostile Congress.

The budget accord promises to reduce the red ink by \$40.1 billion in fiscal 1991 (table) and by \$500 billion over five years. Shorn of some optimistic assumptions and a bit of fancy bookkeeping, it probably will cut spending and raise taxes by \$25 billion to \$30 billion this year and perhaps by \$300 billion by 1995. Under the agreement, the deficit in fiscal 1995 is supposed to drop to \$63 billion. But independent analysts figure the true deficit will probably be at least twice that. After 1992, much of the claimed savings comes from an extremely upbeat view of the economy. "The economic assumptions account for half of the long-term deficit reduc-

tion," says one congressional aide. "Take them out and you're still looking at triple-digit deficits."

Still, there's no minimizing the accomplishment that Bush says was the result of 140 days of "blood, sweat, and fears." The bargainers agreed to the biggest deficit-reduction pact ever. "I give them close to an 80," says Stanley Collender, a budget analyst at Price Waterhouse. "There are some real courageous things in there." Perhaps the bravest, and most politically explosive, is the decision to trim \$60 billion from medicare over five years. Another sign of political daring is the proposal to raise gasoline taxes by 12¢ a gallon



GINGRICH: HOWLING FOR CAPITAL-GAINS CUTS

over the next year, despite the huge runup in oil prices in recent weeks.

Moreover, unlike the tax bills of 1982, '84, and '86, when corporate taxes were hiked by hundreds of billions, there are no broad, new business levies. Some industries, especially insurance, will get hit. But others, particularly energy producers, get new breaks.

NEAR-REVOLT. That means workers and retirees will bear the brunt. And, with elections just a month away, that has legislators running scared. New excise taxes and benefit cuts—and the lack of a tax rate hike on the wealthy—have congressional Democrats in near-revolt.

House Republicans are up in arms because the package fails to include a capital-gains tax cut and relies on a huge tax increase.

With this bipartisan frustration, Bush and the congressional leaders are scrambling. "It is not a proposal that most members of Congress want to rush out screaming in the streets with joy about," says House Speaker Thomas S. Foley (D-Wash.).

The budding revolt, led by Minority Whip Newt Gingrich (R-Ga.) and other House Republicans, was so worrisome that Bush lobbied at least 50 GOP lawmakers and went on national television to peddle the package. "I cannot claim it's the best plan possible, but it is the best agreement that can be legislated now," the President said on Oct. 2. The peripatetic Bush even canceled a four-day fund-raising swing through New England to stay home and twist arms on the Hill. The President is now so committed to the deal that he will oppose efforts by Senate Republicans to tack his cherished capital-gains tax cut onto the package. "We'll be going back for capital gains, but we won't be doing so in the framework of this agreement," says Darman, who admits that winning the tax cut later may be even tougher.

In an indirect way, Federal Reserve Board Chairman Alan Greenspan is also lobbying for passage. On Oct. 3, he bestowed a Fed chief's highest accolade on the pact, telling a congressional commit-

tee it appears "credible." That's a magic word to credit markets, which take it to mean that the Fed will bring down interest rates. But Greenspan warned that rates won't drop much until a package is signed, sealed, and delivered.

The Fed chairman's caution is shared by private economists. "There's still a question mark over whether this is a done deal," says First Boston Corp. economist Darwin Beck. "The Fed won't ease until there is a vote in Congress."

Even with the support of Bush, the Democratic leadership, and Greenspan, the budget package is in for at least three more weeks of tense wrangling.

must rewrite a just-finished farm bill.

Critical details could well be rewritten once committees get their hands on the plan. Most likely are revisions of the tax and medicare provisions (page 28). Some advocates for the elderly hint that they would accede to an across-the-board cut in medicare benefits as long as at least \$2 billion in added assistance is provided for low-income seniors. House health subcommittee Chairman Pete Stark (D-Calif.) has already vowed to overhaul the medicare agreement.

It's hardly surprising that the negotiators left some loose ends. Bush and the Democrats were not only political rivals

but also were pursuing totally incompatible economic policies. Says Senate Majority Leader George J. Mitchell (D-Me.): "What delayed us for months is what has divided us for years. Democrats and Republicans have deep differences over values and priorities."

FAIRNESS. The centerpiece of Bush's domestic agenda has been cutting taxes on capital gains while holding the line against tax increases. Deficit reduction, he insisted, should come from domestic spending cuts. And Republican lawmakers thought that a pro-growth, antitax stance would help them regain control of the Senate.

Democrats, desperately seeking an agenda of their own, elevated the notion of tax fairness into a populist anthem. They hoped to boost their chances of recapturing the White

House by focusing on GOP policies that tilt to the rich. And the Democrats dreamed of a peace dividend that could be spent on child care, education, and health programs.

Neither side got any help from a disillusioned public increasingly resentful of tax hikes or spending cuts. Given that divide, it's not surprising that Bush and congressional Democrats found themselves in a 20-month stalemate.

It was only the hammer of deep, automatic spending cuts effective on Oct. 1 that broke the deadlock. The deal was aided by a backchannel personal relationship between opportunistic Budget

HOW THE BUDGET DEAL WOULD CUT THE FEDERAL DEFICIT

NEW TAX PROPOSALS	Projected deficit savings Billions of dollars/Fiscal year 1991	
Tax hikes on gasoline, other oil products		\$6.8
Higher excise taxes on tobacco, alcohol, and luxury goods		2.3
Limits on itemized deductions for taxpayers earning more than \$100,000		0.5
Other new taxes, including higher taxes on insurers		11.6
Increased tax deductions for small business investments, research and experimentation, energy exploration and other incentives		-5.0
	NET NEW TAXES	16.2
KEY CUTS IN SPENDING	Total spending hikes limited to rate of inflation for domestic discretionary programs, such as law enforcement, transportation, national parks, and education	0
	Cuts in medicare benefits	4.6
	Farm subsidy cuts	1.3
	Defense spending cutbacks; no specific programs targeted	9.8
	Miscellaneous cuts and higher user fees	8.2
	Total spending reductions and higher fees	23.9
	TOTAL FISCAL 1991 DEFICIT REDUCTION	\$40.1

DATA: OFFICE OF MANAGEMENT & BUDGET

"It will be very close, and I fully expect the House Republicans to vote something down along the way to let off steam," says Thomas Korologos, a lobbyist with close White House ties. "But in the end, the President will prevail."

The budget that finally emerges could differ significantly from the blueprint. For one thing, many of the specific changes in law needed to reach the deficit-reduction targets weren't spelled out. For example, the agreement calls for a \$13 billion cut in farm payments, but doesn't say which crop programs should be cut. The task falls to the House and Senate Agriculture Committees, which

Chief Darman and the highly partisan House Majority Leader Richard A. Gephardt (D-Mo.).

The two agreed this summer they would continue private bargaining, no matter how contentious negotiations between Bush aides and the full congressional leadership became. When early-September talks at Andrews Air Force Base broke down, and again when discussions at the Capitol foundered, Darman and Gephardt pressed ahead. On Sept. 28, with the deadline near, the two kept talking in a room off the House floor. Darman, his shirt-tail hanging out, made a last-ditch attempt to keep a capital-gains tax cut in the package. And the normally natty Gephardt, sleeves rolled up and eyes puffy from lack of sleep, insisted Democrats would only accept a gains cut if Bush bought a rate hike.

SMALL SUCCESS. Finally, late on Sept. 29, they wore each other down. The Administration gave up its two-year struggle to cut capital-gains taxes and agreed to a package of incentives aimed at small businesses and the oil-and-gas industry. Democrats dropped their demand for higher rates and settled for a nick in the value of deductions for taxpayers earning more than \$100,000 a year. The compromise satisfied no one, and it left critical policy issues unresolved. But it averted a \$120 billion slash in government spending and an acute embarrassment for both the President and the Democratic leadership.

By that measure, the pact is a success. But the negotiators couldn't pull

SPENDING CUTS: SPREADING THE PAIN FAR AND WIDE



\$4.6 BILLION THE MEDICARE REDUCTION MAY BE THE MOST POLITICALLY EXPLOSIVE



\$9.8 BILLION MILITARY SPENDING WILL BE SLASHED —BUT JUST WHERE?

together the megadeal that would finally get the deficit behind them. Even if the accord is adopted in its entirety, the projected deficit for this fiscal year will be \$254 billion—the largest in history. If a recession hits, as many economists expect, the shortfall could top \$300 billion.

And while the agreement relies less on legerdemain than past accords, it is by no means devoid of sleight of hand. The negotiators took off the books the cost of the savings and loan bailout, which could run an extra \$100 billion this

fiscal year. But they count, for purposes of deficit reduction, the additional fees banks and thrifts must pay into the federal insurance fund.

The pact dodged tough decisions about military spending. It excludes from the Gramm-Rudman deficit targets the \$7 billion cost of the Persian Gulf buildup and won't count added expenses should shooting start. And while the deal is touted as a five-year plan, it includes only about \$67 billion in defense cuts over the next three years. After

Commentary/by Douglas Harbrecht

THE BUDGET IS A SYMPTOM —THE SYSTEM IS THE DISEASE

It's October, 1993. A total government shutdown has been narrowly averted. President Bush takes an urgent phone call from Treasury Secretary Richard G. Darman. "Mr. President, the compromise is coming unglued," says Darman. "The Democrats want you to go to the voters."

Bush hits the road, imploring Americans not to punish politicians who support the five-year, \$650 billion package of spending cuts and tax increases that will bring the federal deficit down to \$300 billion by 1998. "This recession thing took a bigger toll than anyone realized," Bush tells a convention of the Veterans of Desert Shield in Phoenix. "The political reality is, no one can put together a better package."

Sound familiar? Don't be surprised if the scenario plays out two or three times during the coming decade. That's because the \$500 billion deficit-reduction plan that was unveiled on Sept. 30 by President Bush and congressional leaders is another short-term fix that leaves major, chronic problems unresolved.

THEATRICAL COUP. The agreement may be a political triumph, but it's still likely to leave an unacceptably high deficit by 1995. And the persistent deficit, depressing as it is, remains only a symptom of a more serious malady: the inability of a stalemated American political system to resolve the fundamental issues of what government should do and how it should raise the funds to do it.

Since the Reagan revolution petered

out in the mid-1980s, a divided government has failed to do more than split differences. When Bush and Congress began work on the 1991 budget, many believed this might be the year to break down the impasse. In January, Budget Director Darman foresaw the opportunity "to complete the job of fiscal policy correction."

As theater, the 11th-hour budget deal is a coup. As policy, it's another sidestep. "A lot was just left on the shelf," says Carleton College political scientist Steven E. Schier. The deficit was cut, but few of the burning policy questions of the time were resolved (table).

Check out the tax compromise. Democrats began the deficit-reduction process determined to make the tax system more "fair," which they defined as shifting a larger share of the burden to the rich. Bush and the Republicans wanted to rejigger the tax code to provide new incentives for investment.

Both goals are justifiable, but they're hopelessly incompatible. Unable to reconcile their differences, the Administration



\$1.3 BILLION FARM SUBSIDIES WILL BE CHOPPED UNDER THE BUDGET PACT. HOWEVER, THE TASK OF DECIDING WHICH CROP PROGRAMS BEAR THE BRUNT OF THE COSTS IS NOW UP TO THE HOUSE AND SENATE AGRICULTURE COMMITTEES

that, military spending is left open.

The economic assumptions used in the agreement have raised eyebrows among budget analysts. In the short run, the budgeteers assume the economy will dodge recession and grow at a bit less than 1% through calendar 1990 and slightly more than 1% in 1991. Those estimates are close to those of many private forecasters. After 1991, the projections, developed by the Bush Administration, take on a rosy hue. In 1993, the economy is projected to grow by a boom-

ing 4%, while interest rates and inflation fall. Few economists believe such growth can be achieved without inflation. "The Fed would never stand for it," says First Boston's Beck.

What will this deal really accomplish?

At first, it promises to be a drag on an already sluggish economy. A \$20 billion cut in government spending and a \$16 billion tax increase—much of it in consumption taxes—could be a shock to an economy that may already be in a recession. Bush can only hope that the credit

and congressional bargainers came up with a jumble. For fans of tax incentives, there's a new, 25% deduction for investments in small business. For the fairness crowd, there's a 10% tax on luxury items and a scheme to limit itemized deductions among high-income taxpayers. And to bring in some serious money, there's an amalgam of nickel-and-dime increases on gasoline and other petroleum products, beer, wine, liquor, and cigarettes.

That's an extraordinarily complicated way to raise \$134 billion over five years. "We ended up with things that nobody either wanted or ever heard of before," laments Stuart E. Eizenstat, the top domestic policy adviser in the Carter White House.

The spending side isn't any better. The budget summitters were only too happy to avoid dealing with Social Security, the largest single item in the federal budget. In-

stead, the agreement heaps all the individual entitlement cuts on medicare, which is deemed less touchy politically. The result: The cost of Social Security continues to grow unchecked, the problem of funding retirement benefits for future retirees remains unsettled, and the heaviest burden of deficit reduction falls on the elderly sick.

Negotiators couldn't even agree on

markets will take the agreement seriously enough to bring down rates. With many of his aides, it's almost an article of faith. "The deficit reduction is going to bring down the cost of money in the United States," says Treasury Secretary Nicholas F. Brady.

BAGGAGE. But don't expect an immediate economic boost. "For the next six months, nothing would have helped us," says Peter J. Davis, chief economist at Ernst & Young. "It's a stopgap measure to make sure we don't fall further into recession."

The key to the pact's economic success is credibility. While this deal is more serious than its predecessors, it carries a lot of baggage. To make spending cuts stick, it relies on a complex, untested enforcement mechanism that would make it difficult to start a new program or increase spending for an old one without finding offsetting cuts or new revenues. Some of its tax components are bizarrely complicated.

But the biggest handicap is the well-earned skepticism of voters and financial markets. They've watched too many smiling pols proclaim too many breakthroughs, only to see the deficit deepen.

For the budget to work, it must help restore confidence in the economy. Otherwise, a slide into recession will cause the deficit to explode—and no combination of spending cuts and tax hikes will help. That's a lot to ask of any budget deal, even this one.

By Howard Gleckman and Paula Dwyer, with Mike McNamee, in Washington

how to fix a budget process that plainly doesn't work. "They put new nuts, bolts, and springs in a Rube Goldberg machine," says GOP analyst Kevin Phillips. "This farce is humming along nicely." Lawmakers shrugged off the need for basic revisions in the nation's long-term defense policy and chopped at farm programs with no overall strategy.

Can Republicans ever swallow a higher income tax rate for the wealthiest Americans and a defense budget that honestly addresses our post-cold war needs? Can Democrats ever accept structural changes in Social Security and farm policy? When they do, the red ink can stop flowing. Until then, Bush's oft-stated deficit-reduction goal of getting "the job done right" will remain a pipe dream.

UNFINISHED BUSINESS

TAX FAIRNESS OR INVESTMENT INCENTIVES Lawmakers ducked the issue by agreeing to some questionable investment incentives and imposing a new tax on fancy cars and furs

ENTITLEMENT REFORM The fastest-growing programs are the entitlements—medicare, Social Security, farm subsidies. The deal ignores Social Security, nibbles at medicare and farm policy

DEFENSE The serious debate over long-term defense strategy has been put off until 1993. The negotiators agreed to a split-the-difference plan

BUDGET REFORM Negotiators couldn't agree on whether to keep Gramm-Rudman's targets or to install a "pay as you go" system. Instead, they decided to do both

A TAX HERE, A TAX THERE— PRETTY SOON, IT'S REAL MONEY

The new plan is a hodgepodge intended to raise \$134 billion in five years

The latest debate over new taxes has seen more than its fair share of posturing. President Bush challenged us to read his lips and insisted he would never accept any budget agreement that did not include a cut in the capital-gains tax. Congressional Democrats demanded that any deal be "fair" and that the rich pay a higher proportional share of new taxes than the less well-off.

But in the end, expediency, exhaustion, and compromise won out. Attempts to make major changes in the tax code were scrapped. Promised capital-gains reductions fell through the cracks. Threatened higher rates for the wealthy faded away. Instead, White House and congressional negotiators settled on a tried-and-true formula for raising taxes. First, they agreed to a wide range of modest tax increases that would chip away at dozens of existing tax breaks and marginally raise the cost of all sorts of activities. Then, they tossed in some carefully selected tax goodies, designed to buy the support of a few key lawmakers. All those nicks and scratches add up, though. Over five years, Bush and the congressional leadership would raise almost \$134 billion in new taxes.

There are real doubts that Congress will approve the tax package as is. House Ways & Means Committee Chairman Dan Rostenkowski (D-Ill.) warns that he does not feel bound by the specifics of the deficit-reduction agreement. And beginning on Oct. 9, the congressional tax-writing committees will begin to tinker with the package. But while the details may change, it's a good bet that the basic structure will survive.

STEALTH BITER. The framework is simple: Raise taxes on most individuals without changing statutory rates. Put the biggest share of the burden on the middle class. Provide a handful of highly targeted investment incentives. Raise as much money as possible by hiking excise taxes, which have the great political advantage of getting built into prices of goods, never showing up on either pay stubs or tax returns.

Under the agreement, the poorest

Americans would be hardest hit. Families earning less than \$10,000 would see their tax burden rise by 7.6%, according to the congressional Joint Tax Committee, largely because of increases in excise taxes on gasoline, tobacco, and alcohol. The other big losers would be middle-income families earning \$20,000 to \$50,000. They will see their tax bills jump by about 3%. That has Democrats and tax reformers livid. Says Ways & Means member Charles B. Rangel (D-N.Y.): "We blew it. We'll never get an opportunity like this again to make the tax code fair."

The wealthiest taxpayers, who earn more than \$200,000, would see only a 1.7% tax hike. According to an analysis by Arthur Andersen & Co., the tax bite for a typical family of four earning \$200,000 would jump by a modest \$1,619 (table). The well-off would be hit by two major tax hikes. The first is a limit on deductions for either singles or married couples with adjusted gross incomes of more than \$100,000. The second is an

increase in the medicare payroll tax for workers making more than \$51,300.

But the wealthy shouldn't fret. The budget negotiators presented both entrepreneurs and investors with an extremely generous new package of incentives for investment in small and midsize businesses. The proposal would allow taxpayers to deduct as much as \$50,000 a year for investments in companies that are capitalized at \$50 million or less. Later on, sellers of stock in the companies could index their capital gain for inflation. And the businesses themselves would be allowed to take immediate write-offs for capital investment and generous new credits for the cost of research and development.

The Administration hopes the plan will encourage new investment in small business. Says Treasury Secretary Nicholas F. Brady: "It's a statement of belief in the job-creating ability of small- and medium-sized companies."

But critics contend that, at worst, the provision threatens to become the next

HIGHER EXCISE TAXES: THE HIDDEN REVENUE-RAISERS



\$2.1 BILLION THE PRICE OF SIN IS GOING UP AS BEER, WINE, LIQUOR, AND TOBACCO GET HIT



\$200 MILLION LUXURY ITEMS WILL GET DEARER—BUT NOT ENOUGH TO DETER BUYERS

tax-shelter bonanza, little different from the real estate and oil-and-gas scams that were curbed by the 1986 Tax Reform Act. At best, the skeptics say, the proposal would just shift investment to small business at the expense of other sectors of the economy. "It will spur growth in the tax-shelter industry," says William C. Melton, chief economist for IDS Financial Corp. "But as far as the economy as a whole is concerned, the impact will be very marginal."

Small business isn't the only winner. Energy companies get back some of the tax breaks they lost in 1986 and save an expiring write-off for production of natural gas. High-tech companies would get another one-year extension of the research and experimentation tax credit, which was due to expire at the end of 1990.

FINE PRINT. But for every winner, there are losers. The insurance industry would take a nearly \$2 billion beating in fiscal 1991 alone. And U.S. subsidiaries of foreign companies will face some tough new compliance standards. All companies are worried about a proposal that would bar them from deducting interest they owe the Internal Revenue Service on underpaid taxes.

The package includes a proposal described only as "certain business tax provisions." That benign phrase describes up to \$2 billion over five years in

HOW THE NEW TAX PROPOSALS WOULD HIT UPPER-INCOME TAXPAYERS

EFFECT OF CAP ON ITEMIZED DEDUCTIONS AND INCREASED MEDICARE TAX

INCOME	\$73,000	\$73,000	\$140,000	\$200,000	\$300,000
FILING STATUS	SINGLE	JOINT	JOINT	JOINT	JOINT
TAX					
▶ CURRENT LAW	\$15,977	\$13,333	\$31,597	\$51,397	\$79,888
▶ PROPOSAL	16,292	13,333	32,535	53,016	82,197
MARGINAL RATE					
▶ CURRENT LAW	33.0%	28.0%	33.0%	32.9%	28.0%
▶ PROPOSAL	33.0	28.0	34.0	33.9	28.8
EFFECTIVE RATE					
▶ CURRENT LAW	25.4	21.2	26.3	28.6	28.5
▶ PROPOSAL	25.9	21.2	27.1	29.5	29.4

DATA: ARTHUR ANDERSEN & CO.

other corporate levies—details to be agreed upon later. And for the favored few, it would provide congressional tax-writers with a \$600 million honey pot of undefined tax incentives that can be distributed among a few deserving companies. The revenue impact of these provisions won't be known for years.

But the budget agreement avoided the big income-tax changes that nearly became a biannual event in the 1980s. Instead, in what could be the beginning of a new trend, excise taxes became the new target of opportunity. Levied on everything from carbon tetrachloride to pricey cars, these taxes would raise more than \$10 billion in 1991 and more than \$75 billion through 1995. "We can't touch rates, and it's not that easy to broaden the base any more," says Gil-

lian M. Spooner, a partner at KPMG Peat Marwick. "So you have to move out of the income tax."

Taxes on gasoline and other petroleum products will hurt the most. Gasoline taxes will go up by a nickel a gallon in each of the next two years, along with another 2¢-a-gallon tax on all petroleum products. The tax won't cut consumption much—it's too low to change behavior—but it will raise big bucks unobtrusively. Some suspect the push toward excise taxes may be a dress rehearsal for something bigger. Says Spooner: "I call it a back-

door value-added tax."

While the tax on luxury items has received lots of attention, it is not likely to have much impact on consumers. Buyers with their heart set on that shiny new BMW won't let an extra few thousand dollars scare them away.

'DIRECT HIT.' Excise taxes are not the only hidden taxes in the package. The budgeteers proposed increasing the Social Security and medicare tax liability of state and local governments by \$21 billion over five years, new obligations that will be passed straight to taxpayers. "It's a direct hit, right off the top," says Frank Shafroth, chief lobbyist for the National League of Cities. "We'll have to raise state and local taxes to pay a federal tax."

This hodgepodge of proposals does nothing to settle the great debate between those who believe the tax code should be, most of all, progressive and those who insist it should provide incentives for economic growth. And it surely doesn't end the squabble over whether to cut the capital-gains tax—a battle that could be fought anew in the next year or two.

Instead, the proposal tries to achieve a much simpler goal: raising money to help tide over a flat-broke government until the next fiscal crunch. That, after all, was why the income tax was created in the first place.

Once the great budget debate of 1990 is finally over, there will be no broad philosophical arguments about its meaning. Economists won't pore over its details to seek the secrets of the perfect tax code. Rather, after a couple of years, the bean counters will simply tote up how much was collected by this homely and misshapen tax package. Then, they will pass another tax hike, at least as big as this one.

By Howard Gleckman, with Vicky Cahlan and Paula Dwyer, in Washington



\$6.8 BILLION WHILE ENERGY COMPANIES ARE GETTING BACK SOME OF THE TAX BREAKS THEY LOST IN 1986'S REFORM, CONSUMERS WILL BE PAYING 12¢ A GALLON MORE FOR GASOLINE AND 2¢ A GALLON MORE FOR OTHER PETROLEUM PRODUCTS

Commentary/by Karen Pennar

THIS 'DWARF RECESSION' MIGHT BE A GIANT

When the last time you experienced something was eight years ago, it's easy to forget just what the experience was like. But that hasn't stopped dozens of economic forecasters. Now that there's a consensus that the economy is either in or headed for its first recession in eight years, most economists are pretty sure that they know what the downturn will look and feel like. The contraction, they say, will be both short and shallow. That is, it will probably last from six to nine months and gross national product will shrink 1% to 1.5% in that period. In other words, a mild recession.

How comforting—as if the economy were just coming down with a cold. The fact is, nobody really knows how the downturn will play out, and it could turn out to be more prolonged and more painful than most expect. It's true that inventories remain well under control and that housing has already contracted considerably—two things that many economists take as signs that the economy doesn't have far to fall when it does fall (page 21). But there are a number of special factors that could make that plunge a good deal more treacherous. Consider the following:

■ **New imbalances.** In the real economy, where goods and services are bought and sold, there are no excesses or imbalances right now. "No boom, no bust," says Roger E. Brinner, chief economist at DRI/McGraw-Hill. But on the financial side of the economy, where loans are made, the situation is far different. Debt accumulation drove the consumption binge and the merger wave of the 1980s, and ready credit financed persistent government deficits. Now, real estate prices are stalled or falling, business sales are slowing, and the economy's overall growth has been anemic. The economic assumptions underpinning all that debt are vanishing.

So the belt-tightening has begun. In the meantime, though, loans are turning sour and banks are hurting. Until

now, the financial system has sprung some serious leaks—from the savings and loan failures to Chase Manhattan Corp.'s recent funding difficulties—and they've been plugged. But with the financial system so fragile, there could be a cascade of problems "like water mains bursting in New York City," says Neal M. Soss, chief economist at First Boston Corp. Too many at once, and the system may be swamped.

■ **Expectations and the Fed.** This must be one of the most heralded recessions ever. Economists are waiting for it, executives are waiting for it, consumers are waiting for it, and even some government officials are waiting for it—the mild one, that is. Things were slow-

tolerate the two-quarter downturn that might result, he is virtually ensuring that it will happen. He's also running the risk, though, that it could be far worse. Morgan Stanley & Co. economist Stephen S. Roach detects a corporate readiness to "cut costs first and ask questions later." Roach doesn't think this will snowball, but he acknowledges that the process can be self-perpetuating: Workers lose their jobs, incomes contract, people cut spending, sales fall, more workers lose their jobs, and so on. Presto! A cumulative unwinding.

■ **Bad luck and bad timing.** For the past eight years, a run of good luck has kept the economy growing. When the

government ran up massive deficits, foreigners obligingly financed those deficits. When the stock market crashed, the consumer kept on spending. When one sector rolled into a slowdown, another rolled right out of one.

Now, the economy seems to be getting a dose of bad luck. First, there's the pocketbook shock of higher oil prices. Second, thanks to that shock, it seems that growth will be slower in Europe and Japan than imagined only a few months ago (page 46). And that means U.S. exports are unlikely to save the expansion. Then there's the budget accord, which could dampen

growth. Finally, there's the possibility of war in the Mideast. And whatever popular Keynesianism teaches, the loss of life in the Persian Gulf region ultimately won't boost the economy.

Add it all up, and there's not much to be sanguine about. Of course, it's always possible that the pundits will prove to be right, and the recession we get will indeed be mild. But for those whose memory is short or who simply don't know, the dwarf recession is a fairly rare animal. The eight postwar recessions lasted an average of 11 months and registered an output decline of 2.5% in real gross national product—longer and deeper than most experts are forecasting today.



ing down before the Aug. 2 invasion of Kuwait, but the shock to oil prices jolted confidence. Then Federal Reserve Board Chairman Alan Greenspan gave Congress a lesson in semantics: In his book, even if the economy contracts a little for a couple of quarters, that wouldn't necessarily qualify as recession. A real recession, according to Greenspan, is a "cumulative unwinding" of economic activity. The Fed's anti-inflation fight, especially since the oil shock, remains paramount.

Of course, if people expect a downturn, then they prepare for that downturn: Businesses let workers go, and consumers cut spending. And since Greenspan has in effect said he will



GOODYEAR TIRES FOR EARTHMOVERS: DEMAND IS HEALTHY, BUT THE COMPETITION IS TOUGH

HOW WELL CAN GOODYEAR TAKE THE BUMPS UP AHEAD?

Its stock is flattening—and even its durable dividend may not be safe

The big tire wholesaler had just gotten back from a trip to Goodyear headquarters in Akron. He sounded impressed. Goodyear management, he said, was serious about bringing its finances and operations into line with the tough realities of the global tire business. Then he paused and asked: "How safe is the dividend?"

Good question. The quick answer is that for a little while, at least, the dividend is probably safe. But the very question shows the financial pressure Goodyear Tire & Rubber Co. is under. After all, the company hasn't reduced its payout in half a century. It has announced plans to push decision-making authority down into the ranks and to conserve cash. But it's not clear that the moves can insulate Goodyear from the worst effects of a U.S. recession.

FEELING THE PINCH. Such worries are part of the reason the stock market is punishing the big tiremaker's stock. At about 17, just half of where it traded only four months ago and barely more than one-fourth of its 1989 high, Goodyear's market value is only about \$1 billion. At its current price, the stock is yielding more than 10%, vs. 3.23% for the Standard & Poor's 500-stock index. Duff & Phelps Inc. downgraded Goodyear's commercial paper on Oct. 3, and Moody's Investors Service Inc. is considering doing the same to the company's other borrowings. If Moody's acts, Goodyear bonds will become noninvestment-grade—in other words, junk.

Goodyear isn't alone in its troubles. Rivals Bridgestone Corp. and Michelin, which just reported a first-half loss, are also feeling the pinch. Intense competition is offsetting the benefits of relatively strong demand. In Europe, says UBS Securities Inc. analyst Jean-Claude Gruet, original-equipment tire prices are off 18% this year. And in the U.S., where Goodyear remains the leader, production capacity has again outstripped market needs. At the same time, because of weaker car sales, tiremakers earlier this year dumped units intended for Detroit into the replacement market, driving down prices.

With no relief at home or abroad, Goodyear's profits have plunged. After earning just \$27.9 million, excluding special items, on sales of \$5.6 billion in the first half, it announced a month ago that it would lose \$14 million from operations in the third quarter and make only \$14.7 million in the fourth. True, special circumstances are partly to blame: a strike in Turkey, economic turmoil in Latin America. But profits have been sliding since 1987, and Goodyear appears damned no matter what it does: Last year, it raised prices and lost tire sales.

This year, lower prices have boosted sales but are hurting profits.

As a result, Goodyear isn't earning enough to pay its dividend, which costs \$104 million annually (chart). Although its capital spending will decline this year, to perhaps \$600 million, that's still considerably more than depreciation of \$420 million. That has led a number of analysts, such as Merrill Lynch & Co.'s Harvey E. Heinbach and PNC Financial Corp.'s John B. Franck, to class the dividend as "vulnerable." Oren G. Shaffer, the company's chief financial officer, tiptoes around the dividend issue. But he implies that the payout is safe. "The dividend on Goodyear stock now is a very integral part of the value package shareholders are getting," he says. "We consider it very important."

But Shaffer makes no bones about the need to tighten operations. "Any time your operating results fall off the way ours have, you have to adjust your plans and strategies," he says. The company has announced a series of cost cuts, including reorganizations of its U.S. stores operation and its domestic and European sales staff. The moves will trim roughly 3,000 jobs. And in the past year, it has moved to shutter permanently parts of three plants. Chairman Tom H. Barrett also has indicated that capital spending in 1991 and 1992 will be limited to depreciation levels. Those outlays were due for a breather, anyway, since the company is just completing a new plant in Canada and is about done with its switch to radial tires.

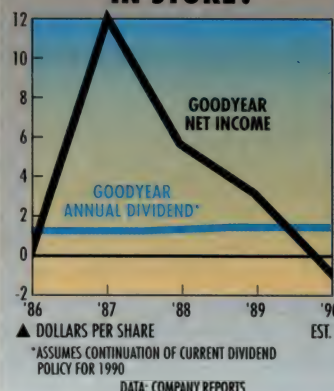
PLENTY OF ROOM? But the capital-spending cap also signals the cash-flow squeeze. To run leaner, Barrett wants to chop working capital by \$300 million to \$400 million. Shaffer is zeroing in on inventories, which rose last year because tire sales were lower than planned. Says analyst Saul H. Ludwig of Cleveland's Roulston & Co., an investment firm: "Goodyear is scaling back its factory operations to bring inventories in line with demand and to conserve cash."

If it wanted to, the company could go deeper into hock to keep the dividend.

It's paying fixed rates on most of its \$3.8 billion in debt, so even a downgrade should not raise costs too much. And Goodyear has \$2.1 billion in untapped, guaranteed borrowing capacity. "I think they've got quite a bit of room," says one lender.

Adding more debt, however, is just what Barrett doesn't want to do. He'd like to pare back the borrow-

IS A DIVIDEND CUT IN STORE?



ings Goodyear took on to fend off raider Sir James Goldsmith in 1986 and finance its \$1.6 billion oil pipeline. The California-to-Texas line is running at less than 30% of capacity, cutting earnings and weighing down the balance sheet. Rising oil prices could make it easier for Goodyear to find a buyer willing to pay what the company would consider a reasonable price. But rising energy costs would

also hurt tire operations by driving raw-material prices up and demand down.

No wonder few analysts will commit themselves to making firm predictions of a turnaround. Some feel the company is hitting bottom and that cost reductions will help 1991 results. But even the most bullish is studying Goodyear and wishing it looked a little stronger.

By Zachary Schiller in Cleveland

WHERE PAYOUTS ARE REALLY GETTING PUMMELED

If stock dividend payments are a sign of general business health, then Corporate America's vital signs are slipping. And if history is any guide, the latest round of dividend cuts is more worrisome evidence that a recession may already be upon us.

Compare the first three quarters of 1990 with the first years of the past two recessions (chart): The 278 corporations that have reduced or eliminated their dividends already exceed 1973's tally and are uncomfortably close to 1981's. So far this year, dividend cuts are up 41% over the same period in 1989.

Nor will the situation improve soon. Bankers Trust Co. projects that the average yearly dividend payout for a Standard & Poor's 500 stock will shrink by 5% in 1991, a sign that corporate finances are stretched thin. Says Kenneth E. Knutel, equities strategist for Kemper Financial Services Inc.: "When you're vulnerable, reducing dividend expenses is simply prudent."

GAS PAINS. Some of the worst off are companies that loaded themselves with debt during the leverage-happy 1980s. Take Unisys Corp., the product of a 1986 union of Sperry and Burroughs made possible by \$4 billion in borrowings. Debt service has left the Blue Bell (Pa.) company with little wherewithal to weather the business downturns in computers and defense electronics. So Unisys has axed a 25¢-a-share quarterly dividend, which will save the company \$160 million yearly. There's a baleful side effect to such a move, though: The stock gets mauled.

Since Unisys' Sept. 27 dividend announcement and a downgrade of its bonds to junk status on Oct. 2 by Moody's Investors Service Inc., its stock has sunk 43%, to 4 on Oct. 3.

Most dividend cutting is occurring in cyclical industries. USAir Group Inc., suffering from rising jet fuel costs and fewer passengers, is ending its 3¢ quarterly payout. Other hard-pressed steel, auto parts, and construction companies may soon follow.

Banks and finance companies have never been immune to recessions, but this time the exceptionally bad real estate market is pummeling their payouts. In September, this hapless group made up 12 of the 21 companies trimming or yanking their dividends. Most prominent is venerable Chase Manhattan Corp., whose 62¢ quarterly dividend was more than

halved in September.

The archetypal widows-and-orphans stocks are the least likely to rein in their dividends. "Electric utilities and phone companies will be stable enough to keep paying," says J. Eric Leo, a managing director at Equitable Capital Management Corp. And limping businesses that want to put on a brave face for shareholders often defend their dividend as if it were the Alamo. Chrysler Corp. is in trouble again, but pledges that its 30¢ quarterly payout remains sacred—despite the auto maker's negative cash flow.

That vow, like the dividend itself, may become a luxury it can't afford.

By Larry Light in New York, with Joseph Weber in Philadelphia



RESEARCH

SEMATECH'S NEW GENERAL

Xerox's Bill Spencer takes over at the chipmaking consortium

The death of Robert N. Noyce last June left a huge void in the semiconductor industry. Noyce, a Silicon Valley founding father, had headed Sematech, the consortium dedicated to restoring U.S. chipmaking prowess. Industry executives wondered where they could find a leader who would command as much influence and respect.

On Oct. 3, the industry got a surprising answer: William J. Spencer, 60, senior technical officer at Xerox Corp. He is not widely known in the chip industry, but key executives say he has what Sematech needs. "His people skills are excellent," says Charles E. Sporck, CEO of National Semiconductor Corp. and a member of the selection committee.

INDUSTRIAL POLICY? Spencer started his career in semiconductor research at American Telephone & Telegraph Co.'s Bell Laboratories in 1959 and later worked at Sandia National Laboratories. At Xerox, he proved he knew how to turn technology into products, a key issue for Sematech. Most recently, he persuaded warring technical factions at Xerox to work together to bring out Xerox's DocuTech Production Publisher, a blend of computer and copier technology introduced on Oct. 2 (page 40).

At Sematech, Spencer will need all his consensus-building skills. U.S. chipmakers have traditionally been a fiercely independent lot. The consortium—funded jointly by member companies and \$100 million from the Pentagon—is supposed to bring chipmakers and semiconductor-equipment makers together to develop leading-edge technology. Spencer told BUSINESS WEEK he thinks research funding at member companies should focus on pure technology rather than on developing specific equipment. The resulting technology can at first be sold only to Sematech members. Other U.S. chipmakers get their shot much later.

That approach sounds like industrial policy—anathema to the Bush Administration. Jeffrey L. Mayer, director of the Commerce Dept.'s Office of Policy Analysis, says the Administration supports Sematech but "opposes industrial policy. You reconcile the two." To do that, Spencer's technology and political skills will have to be just as good as billed.

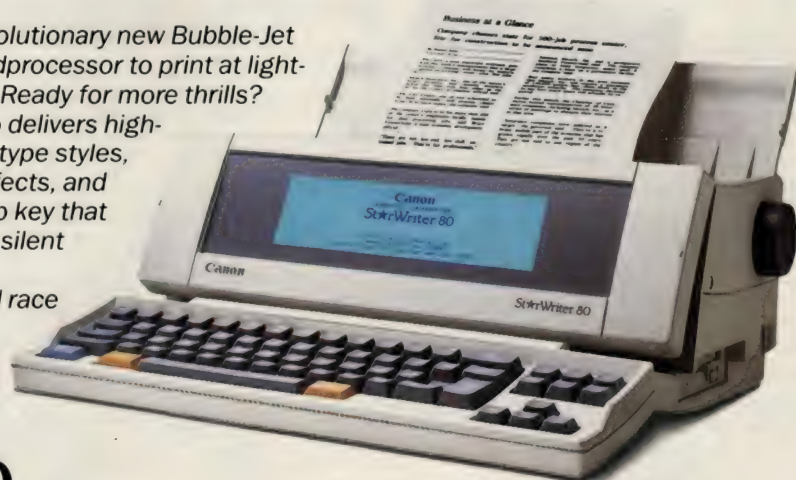
By Richard Brandt in San Francisco



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StarWriter 20, featuring enhanced thermal transfer printing, available soon.

IN COMPUTERS, A SHAKEOUT OF SEISMIC PROPORTIONS

Painful change is everywhere—but mini makers are hit particularly hard

Remember the Massachusetts miracle? It was built in part on the fortunes of big computer makers Digital Equipment, Data General, Wang, Prime Computer, and others. Now, that miracle has turned to a nightmare. And not just for Michael S. Dukakis. Wall Street is expecting Digital Equipment Corp. to report an estimated \$26 million quarterly operating loss, the first in its proud 33-year history. Data General Corp. is reeling, as is Wang Laboratories Inc. In late September, there were rumors—vehemently denied by the companies—that the two would merge.

But it's not only the pride and joy of Massachusetts that are suffering. The 1980s were a decade of flourishing expansion, when new computer makers seemed to spring up almost weekly. Now, the industry is on the verge of a momentous shakeout, brought on by sweeping technological change and a sagging economy. Most vulnerable are the minicomputer makers and aging mainframe companies.

RULE CHANGE. The signs of painful change are everywhere. After eliminating its common-stock dividend and seeing its debt rating plunge, mainframe maker Unisys Corp. has lost nearly half of its market value. In Europe, Japanese powerhouse Fujitsu Ltd. agreed in July to buy 80% of Britain's flagship computer maker, International Computers Ltd., a company believed by its own management to be too small to survive alone. And French government officials recently urged national computer champion Groupe Bull to find a European partner—either Italy's Oli-

vetti or Germany's Siemens. Meanwhile, Digital—and other minicomputer makers such as Data General, Hewlett-Packard, Wang, and Prime—are increasingly vulnerable to the microprocessor.

Indeed, the computer-on-a-chip is radically altering the economics and competitive rules of the computer business. Mini makers once thrived on selling proprietary machines for \$100,000 or more. Today, though, the same work may be done on a \$5,000 machine based on one of a few standard microprocessors. The rise of workstation maker Sun Microsystems Inc., for instance, has been largely at the expense of Digital's minis.

But it's harder to differentiate microprocessor-based machines from the competition's and price them to earn traditional profits. Computer makers that used to enjoy gross margins of 60% or 70%, says James E. Ousley, president of Control Data Corp.'s computer-products group, "need to be at a point where they can make a reasonable return on just 30% to 40%." So they are slashing payrolls, focusing on niches, and even selling off divisions. "We're all having to deal with the infrastructure we built up over the past 20 or 30 years," Ousley adds. "Our margins are never going to be the same."

RUSH TO STANDARDS. This profound change helped thrust Prime Computer Inc. into a drawn-out takeover drama that ended in a leveraged buyout. Data General since 1984 has had to cut its payroll by 45%. And Wang, although still strong in the legal market, is just a shadow of its former self.

To cope, companies are rushing to embrace standards—the so-called "open systems" market—primarily with low-priced desktop computers. Yet none has succeeded in offsetting the slide in profits from proprietary gear. Even Hewlett-Packard Co., one of the earliest to move into open systems, has watched its operating margin shrink from 11% in 1986 to an estimated 9.1% this year, analyst Kevin A. McCarthy of Mabon, Nugent & Co. points out. And even as mini makers strive to keep expenses from ballooning, a recession could deny them much benefit: They "may be ready to turn the corner when there ain't no corner to turn," says Robert Kidd, an industry analyst with Dataquest, a market researcher.

Only two mini makers are counting on continued strong sales of proprietary gear—IBM with its AS/400 line and Digital with its Vaxes. But both are also pushing hard into open systems and emphasizing networks to connect all computer brands. And Digital is feeling severe pressure: IBM is more competitive in minis



ASSESSING THE MINI MAKERS

	Strength	Weakness
DIGITAL EQUIPMENT	Large, loyal customer base; financially strong	High costs despite slowing revenue growth
HEWLETT-PACKARD	Strong technology; diversified	Still struggling with acquisition of Apollo
DATA GENERAL	Low overhead; strong in Europe	Small market share; losses scaring off offers
PRIME	Concentrating on CAD/CAM niche	Shrinking role in higher-profit commercial market
WANG	Strong in legal market and image processing	No workstations, lagging in "open systems"
BULL HN	Government markets	Aging technology

DATA: DATAQUEST INC., BW

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Top of the News

than it was a few years ago. And Digital's heavier dependence on minis means it's more vulnerable to micros. For Digital, says Joseph Payne of Alex. Brown & Sons Inc., "IBM is a rock, and PCs are a hard place." Now, insiders say Digital may shake up its U.S. sales force.

NO MERGER MANIA. Groupe Bull, meanwhile, is readying a wide-ranging turnaround plan to reduce losses that totaled \$331 million in 1990's first half. Sources speculate that some big layoffs and an accelerated shift of development resources to open systems are in the

works. There may also be a management shakeup at Bull's Zenith Data Systems unit in Illinois, which it acquired last December for \$511 million.

A recession, experts say, isn't likely to spark a wave of deals. "There are easier areas to do mergers" in than computers, says Sanford R. Robertson, a San Francisco venture capitalist. Analysts point to Unisys, a conglomeration of Sperry Corp., Burroughs Corp., and other companies, to show what can go wrong. It has hardly turned into the strong rival to IBM that its boosters once forecast.

As for Japanese companies swooping in on struggling American computer makers, that likely would raise a political storm.

So the U.S. will likely see its second-tier computer makers try to stick it out on their own, picking shots carefully and fighting to survive as best they can. That may not be enough. When the dust settles after the shakeout, many U.S. computer companies may be goners.

By John W. Verity in New York, with Gary McWilliams in Boston and Jonathan B. Levine in Paris

INDUSTRIES



GRAPE GLUT: THE AVERAGE COST OF A CASE OF CHARDONNAY SHOULD DROP BY 5% TO 10%

WHY CALIFORNIA WINEMAKERS ARE CRYING IN THEIR CHARDONNAY

Big harvests have prices falling—and the fight for shelf space is vicious

In early September, Dennis Groth, owner of a small winery in the heart of the Napa Valley, was all set to sell 100 cases of his premium chardonnay to an upscale restaurant. But suddenly, the restaurant's wine buyer demanded a discount of 25% for each \$112 case. Groth refused. "I couldn't believe it," he says. "When I asked why, they said: 'Why not? Everyone else is doing it.'"

Groth's disgust is turning into a chardonnay lover's delight. As this year's harvest makes its way from vineyard to winery, the \$3.5 billion California industry is again suffering from too much of a good thing. That means that wine retailers are bracing for a flood of moderately priced offerings from producers of

fering great bargains to win pride of place on store shelves.

Chardonnay grape growers have good weather and overplanting to blame. They had their largest harvest ever in 1989—162,000 tons, a 40% hike from 1988. This year's harvest should fall short of that, but not by much. The glut translates into lower retail prices: The average cost of a case of chardonnay this fall should drop 5% to 10%.

While consumers may relish the bargains, the glut only complicates an already softening wine market. Overall wine consumption has been down for several years running. The chief victim has been the lowest-priced "jug" wines, but last year, domestic premium wine

sales grew only 6%, according to a report by investment bank Hambrecht & Quist Inc. And although chardonnay seems to be faring better than most, makers of super- and ultrapremium wines may get hurt as less expensive chardonnays turn consumers' heads.

Many of those cheaper vintages are likely to bear the unfamiliar labels of buyers selling inexpensive bulk wine under their own names. These "fighting varietals" combine the distinctive stamp of grape varieties such as chardonnay or zinfandel with low prices—many bottles cost from \$3 to \$7 in California. "You will see new entries taking advantage of low prices," predicts Mike Benziger, managing general partner of Glen Ellen Winery, which will produce more than 1 million bottles of chardonnay in 1990.

WARFARE. Glen Ellen, like other now-familiar brands, established itself by producing fighting varietals during the wine glut of the early 1980s. Wineries that outlived the surplus owe their survival to skill at matching quality with low cost. The same holds true today. Says Dewey Kwong, buyer for Cost Plus Wine Shop in San Francisco: "If you don't have the right label or the right product, you could put \$1.99 on it, and it wouldn't sell."

Not all winemakers are battenning down the hatches. Jack Cakebread, president of the Napa Valley Vintners Assn. and head of Cakebread Cellars, insists that wines with considerable cachet, such as his Chardonnay Reserve—retail price \$27—will still command top dollar. "I think you have to look at it case by case, winery by winery."

Meanwhile, some producers believe a chardonnay glut could have a silver lining: Low prices could attract new wine drinkers who previously have resisted prices of \$10 or more for a good California chardonnay. But Liquor Barns Inc.'s Cameron Wilson thinks most new buyers will just be switching from other varietals. In either case, some California chardonnay producers may soon be suffering from a painful hangover.

By Laura Holson in the Napa Valley

They don't brag about their kids,
or make you watch slides of their vacations.



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What are you saving the Chivas for?





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In Business This Week

EDITED BY HARRIS COLLINGWOOD

XEROX WANTS TO BE MORE

► Can Xerox be more than just a copier company? On Oct. 2, it unveiled the first of a new product line that scans, copies, and prints documents with resolution rivaling that of an offset press. Priced at \$220,000 a pop, the DocuTech Production Publisher will be marketed to offset printers and big corporate print shops searching to save time and money. Future enhancements will link the machine to computer networks and allow various kinds of bookbinding.

The rollout hype puts the product right up there with Gutenberg's press. Yet, while the DocuTech is more powerful and sophisticated than rivals' machines, competitors offer individual components that perform the same tasks. And Xerox is racing the Japanese to release cheaper machines that will bring offset-quality printing to the desktop.

ARBITRON LOSES ONE TO NIELSEN

► Arbitron is shutting down its retail-tracking unit, SAMI, a victim of rival A. C. Nielsen's superior capabilities in following which products sell where. Just 2½ years ago, Arbitron paid Time Inc. \$60 million for SAMI.

Arbitron says it now will take on Nielsen by pooling its data with upstart research firm Information Resources. The thinking is that Arbitron's TV ratings and advertising information, combined with Information Resources' supermarket scanner data, will produce a viable competitor to Nielsen.

FNN VS. ITS BEAN COUNTERS

► Financial News Network, a 24-hour cable channel for business news, said on Oct. 2

that a disagreement with its auditors may result in a bank loan default and a substantial loss for its fourth quarter, ended June 30, and the year.

The dispute is over how FNN should account for the \$28 million it spent to develop FNN:Pro, a new stock-quote and video service it offers to brokers and professional traders. FNN wants to spread out the cost. The auditors want FNN to take the hit in one quarter. If they prevail, the company might, in the worst case, have to pay off \$48.5 million in bank debt. FNN execs are talking to bankers about waivers to prevent default.

PET MAY DO BETTER WITHOUT ITS OWNER

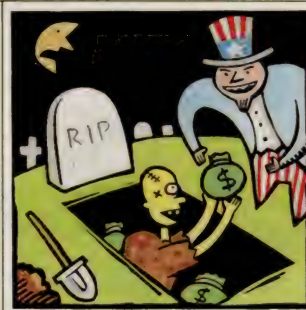
► Whitman Chairman James Cozad is reversing his publicly stated goal of building a food-and-beverage company. The company on Sept. 28 said it would spin off to shareholders its largest unit, \$2 billion packaged-food maker Pet.

Cozad says that as a stand-alone stock, Pet "will get the value in the market that it wouldn't have gotten as part of Whitman." Yet despite the market bias against conglomerates, he says he intends to keep Whitman's remaining units—Midas muffler shops, a Pepsi bottler, and a food-equipment maker—under one corporate umbrella.

THE IRS WON'T TAKE DEATH FOR AN ANSWER

Death and taxes. The Internal Revenue Service won't let the former interrupt collection of the latter. Just ask Ehsanolla Motaghed. Well, you can't.

Motaghed, who in life was an Omaha importer of optical lenses, was indicted last April for allegedly bribing an IRS agent. But he died at age 66 before going to trial, still owing, say the feds, \$157,000 in back taxes. Gravely suspicious, the U.S. Attorney in Omaha asked to exhume the body to make positive identification. "The U.S. Attorney's Office has been watching too many Alfred Hitchcock movies," James Davis, Motaghed's attorney, told the *Omaha World-Herald*. At that point, Assistant U.S. Attorney Thomas Thalken backed off, conceding that "the person who allegedly was dead is dead." But you still can't take it with you. Another assistant U.S. attorney has filed papers seeking to seize the \$110,000 Motaghed posted as bail before his death.



Some investors seemed remarkably prescient about Cozad's change of heart. On Sept. 27, trading volume in Whitman stock topped 1 million shares. Average daily volume is less than half that.

A DANCING PARTNER FOR VESTRON

► Vestron, the tiny home-video distributor that broke into movie production in 1987 with the blockbuster *Dirty Dancing*, is down to its last tango. On Oct. 2, the financially pressed company announced that its three largest creditors had agreed to Live Entertain-

ment's bid to acquire Vestron. In the deal, subordinated debtholders would receive Live securities, while common shareholders would see their stakes nearly wiped out.

Live, in turn, will get Vestron's domestic home-video library of about 1,200 titles. The Los Angeles company also gets a shot at big earnings with the production rights to *Dirty Dancing II*.

WILL HBJ UNLOAD MORE ASSETS?

► The last of the old guard at Harcourt Brace Jovanovich has faded from the scene. On Sept. 28, the publishing company announced that Chief Operating Officer William Brandner, an associate of former Chairman William Jovanovich, had resigned. The departure may signal further asset sales at HBJ.

Expectations on Wall Street are that HBJ's three insurance companies now will go on the block. A company spokesman says there is no connection between the resignation and the future of the units. However, CFO Robert Evanson, who oversaw the sale of HBJ's theme parks in 1989, is overseeing the insurance outfits.



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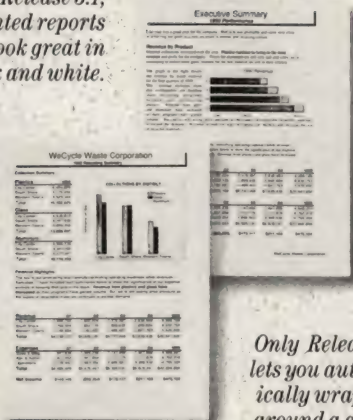


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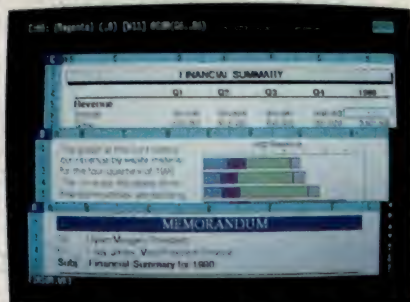
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WeCycle Waste Corporation 1990 Recycling Summary

Last year was a good year for the company. WeCycle was profitable and came very close to achieving our goals in a very uncertain economic and recycling climate.

Revenue by Product

Material collections increased over the year. Plastics continue to bring in the most revenue and profit for the company. Prices for aluminum are still very soft and while we're continuing to collect more glass, markets for the raw material are still in their infancy.

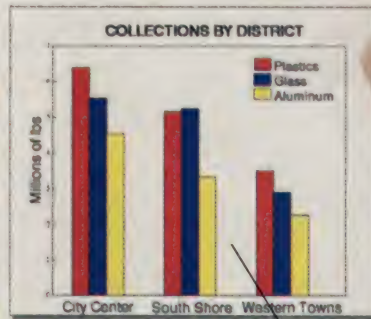
Revenue	Q1	Q2	Q3	Q4	1990
Plastics	1,890,785	1,982,024	2,378,397	2,836,993	9,088,199
Glass	1,700,504	1,852,135	1,868,430	2,600,684	8,032,753
Aluminum	1,146,864	1,182,022	1,489,421	1,601,763	5,420,090
Total	\$4,738,173	\$5,026,180	\$5,737,248	\$7,039,430	\$22,541,032

The graph at the right details our revenue by waste material for the four quarters of 1990. The revenue increases show that communities are building their recycling programs beyond just collecting plastics. Revenue from **aluminum** and **glass** have increased as their programs have gained volume. But, we're still seeing price pressure as the supply of recyclable materials continues to exceed the demand. We need to look for ways to expand our markets and increase the use of recycled materials.



Collections by District

Plastics	1990
City Center	6,403,829
South Shore	5,175,450
Western Towns	3,523,344
Total	15,102,623
Glass	
City Center	5,538,812
South Shore	5,247,930
Western Towns	2,899,356
Total	13,686,097
Aluminum	
City Center	4,555,539
South Shore	3,341,280
Western Towns	2,277,341
Total	10,174,159



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WHATEVER HAPPENED TO THE GREAT ABORTION DEBATE OF 1990?

A funny thing happened to the abortion issue on the way to this fall's elections. After the Supreme Court set off a fire storm last year by freeing states to restrict a woman's right to end a pregnancy, pro-choice Democrats thought the issue would be a huge advantage in 1990 races. But as election day nears, the abortion debate has become curiously muted.

This fall's campaigns show that while a pro-choice position is usually a plus, candidates still must convince voters that they can fix potholes, balance budgets, and improve education. What's more, the abortion argument has been drowned out by recession fears and the specter of war in the Middle East. "People are tired of the issue," says Randy Enwright, executive director of the Iowa Republican Party. "They just don't want to be beaten to death about it."

'900-POUND GORILLA.' In the months that followed the high court's *Webster* decision, state legislatures were the abortion battleground. By and large, only measures requiring minors to get a parent's permission for an abortion won acceptance. More severe restrictions were either vetoed or struck down by courts. Few states are now contemplating draconian curbs.

President Bush also turned down the heat. By proclaiming that the GOP's "big tent" was large enough to hold all views on abortion, Bush's political advisers freed Republican candidates to ignore the party's tough antiabortion platform. And the President resisted pro-lifers' demands that he appoint an avowed foe of abortion to the Supreme Court. Instead, he picked David H. Souter, who said he was open-minded on the question. On Oct. 2, the Senate easily confirmed the New Hampshire jurist.

In Iowa, abortion was to have been central in races for both the governorship and a Senate seat. But the issue hasn't caught fire. Pro-life Governor Terry E. Branstad has a com-

fortable lead over his pro-choice Democratic challenger, Donald Avenson. In the Senate contest, the situation is reversed, with pro-choice freshman Tom Harkin edging pro-life GOP challenger Thomas Tauke.

Abortion has also faded from the debate in Florida, where GOP Governor Bob Martinez was embarrassed when the legislature killed his antiabortion proposals. The Democratic challenger, former Senator Lawton M. Chiles, is locked in a neck-and-neck race with Martinez but has hardly mentioned the issue.

"It's sort of the 900-pound gorilla that fortunately is asleep," says University of Florida political scientist Richard K. Scher. "Why wake it up and divide people further?"

FLIP-FLOPS. Initially, conventional wisdom held that any politician who flip-flopped on abortion was doomed. A Rutgers University study of the 1989 New Jersey governor's race suggests voters rejected what they perceived as pro-life candidate Jim Courter's attempts to portray himself as pro-choice. But after long agonizing, some politicians now find it safer to ease their opposition to abortion. Maryland Democratic Governor Donald Schaefer, who just saw three antiabortion state senators ousted in a primary, recently announced he was pro-life as a person but pro-choice as governor. And in Georgia, Senator Sam Nunn, perhaps eyeing a 1992 run for the Democratic Presidential nomination, told constituents he was changing his position to pro-choice.

The calm may not last forever. A deeply divided GOP faces a wrenching internal fight over abortion when it drafts its 1992 platform. And a Supreme Court decision overturning the 1973 abortion-rights ruling could quickly bring the issue back to center stage. But after 10 years of warfare between pro-lifers and pro-choicers, all but the most dedicated activists seem ready for a cease-fire in the abortion wars.

By Tim Smart, with Gail DeGeorge in Miami



IOWA SENATOR HARKIN:
PRO-CHOICE AND IN THE LEAD

CAPITAL WRAPUP

REAPPORTIONMENT

Conflicts between states and cities are causing new problems for the troubled 1990 U. S. Census. Urban interests, including House members from big cities, are anxious for the Commerce Dept. to correct what the pols regard as a huge undercount of inner-city populations. Commerce, which hasn't yet decided whether to try to correct for the undercount, says it couldn't possibly complete the complex calculations before next July. But states are anxious to get on with the chore of reapportionment and want final population numbers by next Apr. 1, as required by law. Speedy certifica-

tion of the census is especially important in the six states, including Illinois and New Jersey, that hope to redistrict in time for legislative elections next fall. But cities fear that once states begin drawing new districts, any undercount adjustment would be moot.

CONVENTIONS

San Diego, which submitted a late bid for the 1992 Republican Convention, may walk off with the prize. GOP staffers have been especially impressed by the San Diego arena and by the city's transportation services. New Orleans is still in the running, but Republicans are reluctant to go back to the site of their last meeting.

CLEAN AIR

Will an overhaul of the Clean Air Act die in the 101st Congress' rush to adjournment? Despite the huge investment by the Administration and key lawmakers in the legislation, it could happen. House and Senate negotiators are hung up on major issues, including acid rain, car emissions, alternative fuels, and toxic pollution. House conferees are beginning to fight among themselves while senators threaten a walkout. The White House's latest attempt at a compromise fell short. One top environmental lobbyist now says the odds of success this year are down to 60-40.



SO LONG, 'EUROPHORIA'— IT WAS NICE WHILE IT LASTED

Pricier oil, inflation fears, and sluggish growth have torpedoed the wild optimism about 1992

Until this summer, it seemed as if nothing could stop the European miracle. Propelled by the strong winds of German reunification, the opening of fledgling Eastern markets, and the drive to create an economic bloc by 1992, Europe seemed to be entering a decade of unfettered growth. But now, as Middle East tensions pump up oil prices and inflation fears push interest rates to 10-year highs, Europe's hopes are crumbling. "Europhoria is gone," says Maurice Lippens, president of Brussels-based insurer Groupe AG.

All across Europe, executives and government officials are coming to the same conclusion. No one thinks Europe's economy is about to fall off a cliff just yet. Germany's massive unification effort will help European gross national product expand by 2.4% in 1990, estimates economist Richard Reid of UBS Phillips & Drew Securities Ltd. (charts). But that would still be Europe's slowest growth

in five years. In fact, as the past few months' stock-market turmoil (table) focuses attention on fundamental problems many executives had overlooked, it is becoming clear that Europe's pre-1992 optimism was overdone.

Well before the Persian Gulf crisis be-

gan in August, the cheap dollar and a slowdown in exports to the slumping U.S. were beginning to take their toll on profits. Now, faced with near-recession in Britain and with weakening earnings and overcapacity in a wide range of key industries across Europe, dispirited executives are cutting back investment plans. Consumers are slowing spending and boosting savings. And some governments, including Germany, France, and Spain, are slashing expenditures or thinking of raising taxes.

Spreading malaise could intensify existing strains on Europe's 1992 unity push. It is already delaying plans to strengthen the European Community's trading bloc by establishing a single central bank and currency. But unless there is a quick and favorable resolution of the gulf crisis, it's hard to see how the recent damage can be contained.

If oil prices stick at \$30 to \$35 a barrel, says the Confederation of British

THE CARNAGE ON EUROPE'S BOURSES

	Percent change since Jan. 1*	
	In local currency	In dollars
PARIS	-25.5%	-16.8%
FRANKFURT	-25.4	-19.2
ZURICH	-24.0	-10.0
BRUSSELS	-22.4	-13.9
AMSTERDAM	-22.2	-15.1
MILAN	-19.0	-11.8
LONDON	-17.9	-3.9

*Through Sept. 28

DATA: BRIDGE INFORMATION SYSTEMS INC., BW

Industry's chief economic adviser, Douglas McWilliams, Europe's growth could skid to 1%. Even if oil falls back to \$25, many economists say Europe may be facing a stretch of slow growth instead of the beginning of the golden decade it has long envisioned. In fact, with the U.S. already on the brink of recession and Japan facing financial stresses following its stock-market collapse (page 48), a weakened Europe won't be able to help hold up the slowing world economy, as many had hoped.

A sharp reversal in corporate profit growth is one reason so many executives are turning pessimistic. Take Société Générale de Belgique, the huge conglomerate still recovering from a 1987 raid by Italian industrialist Carlo De Benedetti. It now expects 1990's net will be down by at least a third, as arms sales and mining activities slacken. Move on to Britain, where the economy is staggering under 10.6% inflation and 15% interest rates. Proclaiming that housing is in the worst slump "of any during my lifetime in the business," Sir Clifford Chetwood, chairman of builder George Wimpey PLC, recently reported a 72% drop in first-half earnings. Then stop in Italy, where auto maker Fiat recently recorded a 13% drop in first-half profits and announced it would furlough 35,000 workers. "The party is over," says Chairman Gianni Agnelli.

PLANS ON HOLD. Mounting gloom could bring to a close a decade of mergers, acquisitions, and restructurings aimed at helping position companies to compete globally and within the EC's new free-trade system. Europe recorded some \$40 billion in takeovers during the first half of 1990. But most computer, semiconductor, and auto makers are still too small to compete globally.

Many are counting on Germany to keep Europe moving along. Most forecasts still put German growth at 3.25% this year and 3% in 1991. But those estimates may be coming down soon. Even before Saddam Hussein's troops marched into Kuwait, Germany was looking less robust than common wisdom suggested. Commerzbank recently predicted flat to lower production next year in a dozen key industries, including autos, computers, and food. And profit growth is slowing to a third of last year's 13% rate. Rebuilding East Germany should, in time, pump up growth again. But the initial impact will be to slow things down.

Europe's slump is hitting blue chips across the board. Telefónica, the Spanish telephone monopoly, has seen orders for new lines drop by 6%, its first downturn in five years. It may pare capital spending by \$1.8 billion. High oil prices and dollar weakness could drive pretax earnings for German chemical maker BASF

Group down as much as 40% for the year. And Belgium's state airline Sabena may lose as much as \$266 million.

Electronics companies are particularly vulnerable. A victim of the spreading shakeout in the European computer industry, Italy's Olivetti laid off 2,000, as its first-half profits slumped by 41%. France's Groupe Bull lost \$331 million in the first half, on top of a \$41.8 million deficit last year. And Philips, Europe's largest consumer-electronics maker, expects to lose about \$1.1 billion this year, because of restructuring charges and inventory write-offs in computers and chips. The losses could be a signal that Europe's high-tech strategy is falling apart. Despite massive government and industry spending and hard-nosed trade policies, electronics makers are still failing to gain enough market share to fund high research and development budgets.

CARS STALLED. If electronics are bad news, autos are turning out to be a bloodbath. With gasoline prices on the rise, Jacques Calvet, chairman of French carmaker Peugeot, expects European sales to decline nearly 1% this year and an additional 3% in 1991. Calvet is calling on the EC to freeze Japanese auto makers' 10% market share until the year 2003, vastly more restrictive than the European Commission's proposed 18% limit. Renault expects 1990 profits to fall more than 8%, and Germany's Volkswagen recently announced first-half pretax earnings fell by 16.5%.

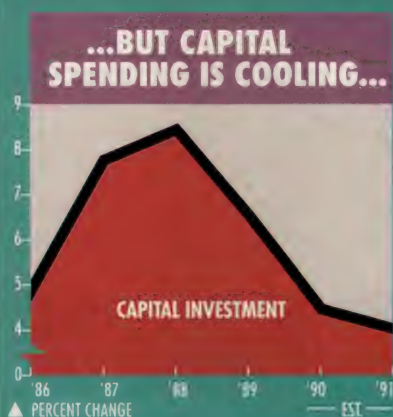
Weakening car sales mean poorer prospects for such auto suppliers as France's Michelin, the world's biggest tire maker. Although Chairman François Michelin had been warning about falling profits for some time, the size of the group's first-half loss—\$69.8 million—shocked the Paris bourse when it was announced in mid-September. Michelin may lose as much in the second half as it did in the first.

Some companies are selling the family jewels to finance earlier acquisitions. British media mogul Robert Maxwell, for one, is preparing to shed at least \$450 million in assets to lighten the \$3.6 billion debt that's burdening his Maxwell Communication Corp.

But will buyers be as willing to pay a high price to get in on the European miracle? Without doubt, Europe remains set on creating a single market of 320 million consumers that will rival the U.S. and Japan economically. But as the oil market sends off signals unheard since the 1970s, Europe's old self-doubts are returning. If they spread, the unity sprint may slow to a crawl just a few yards from the finish line.

By Blanca Riemer in Paris, with John Templeman in Bonn, Jonathan Kapstein in Brussels, John Rossant in Milan, and bureau reports

WHAT'S BOTHERING EUROPE



DATA: UBS PHILLIPS & DREW LTD., NATIONAL WESTMINSTER BANK PLC

'THE ERA OF EASY MONEY IS OVER'

In Japan, the cost of capital is soaring. But so far, cash-rich multinationals haven't felt the pinch

It didn't grow on trees. But money came easy to many Japanese companies in the late 1980s, thanks to the turbocharged stock market in Tokyo. The money till helped Japan hastily retool its export machine to pump out lower-cost products while the yen doubled in value. It underwrote \$162.4 billion in overseas investment from 1986 to 1989. Even massive takeovers, such as Sony Corp.'s \$3.4 billion buyout of Columbia Pictures Entertainment Inc., were a snap. To help pay for the takeover, Sony was able to issue bonds with rates as low as 0.3%.

The cheap money machine is now grinding to a halt. Stock prices have

plunged 41% since the start of the year, wiping out \$1.8 trillion in value—about three-quarters of Japan's annual gross national product. Interest rates are up sharply. To attract money, cash-hungry companies are suddenly offering investors sweeter deals on bond issues, and Japan's brokers are limiting new issues to \$340 million. "The era of easy money is over," declares Seiki Nakajima, director of finance at household goods maker Kao Corp.

But that doesn't mean Japan's economy is cracking up (chart, page 50). Although the capital crunch will squeeze Japan's financial sector and punish some smaller manufacturers, top-name multi-

nationals are still on a roll. Their well-stocked treasure chests mean they will not have to turn to the financial markets anytime soon, insulating them from higher capital costs. Matsushita Electric Industrial Co. has enough cash to buy MCA Inc. twice over at its rumored asking price of \$7.5 billion. Having tapped the markets for an extra \$2.5 billion since last October, Matsushita says its current \$3.2 billion capital spending plan is fully funded—and will hardly drain its \$24.6 billion reserve. Toyota Motor Corp.'s \$4.2 billion spending plan for 1990 barely dents its \$15.9 billion hoard. Hitachi Ltd. has \$15.8 billion in cash, and other top manufacturers are nearly as well set.

While Japan's stock market has been in trouble, forecasts are still calling for GNP to grow by more than 6% this year, the highest rate since before the 1973 oil crisis. Whereas U.S. officials are fretting about the U.S. economy tilting into recession, the biggest worry of Japanese bureaucrats is restraining too-rapid growth and avoiding inflation, caused in part by higher oil prices and labor shortages. Rather than campaigning for lower interest rates, the Bank of Japan is expected to raise rates again later this fall to keep growth under control.

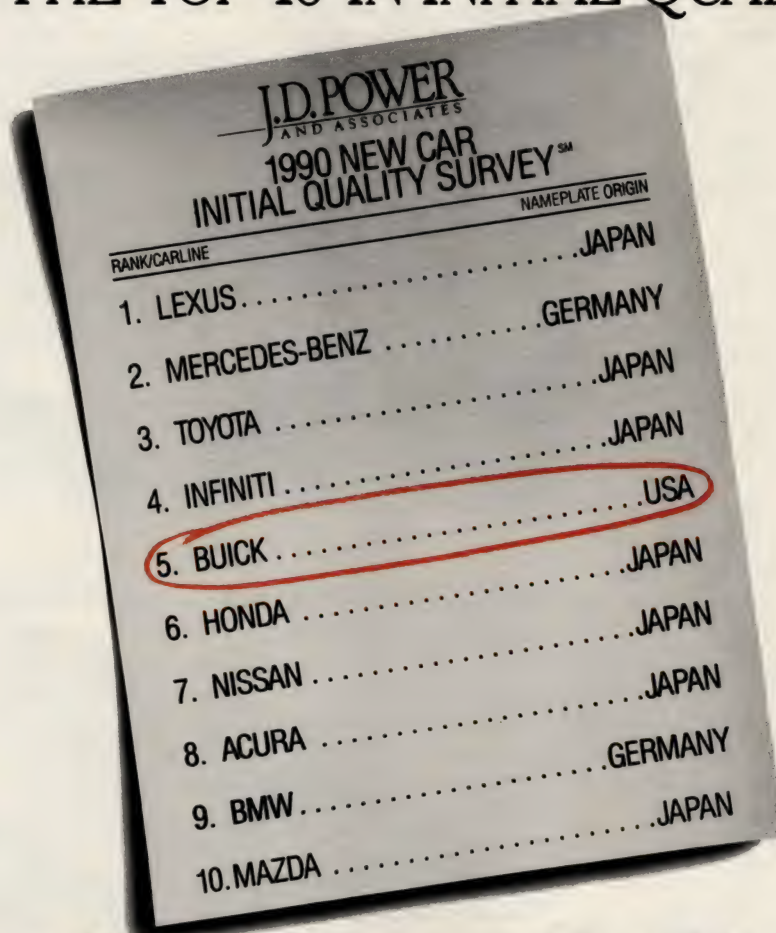
'ADJUSTING.' Overall, experts say stock market excesses of the late 1980s are being squeezed out of the system in a way that will strengthen Japan's top manufacturers. More resources are going to be devoted to making things. "There's a note of glee when people say: 'The Japanese are getting theirs,'" says Edward J. Lincoln, senior

DESPITE FALLING STOCKS, GROWTH

Prices on Tokyo's stock exchange (left) have plunged 41% since the year began—squeezing financial markets and small businesses. But big companies such as telecommunications giant NEC Corp. (right) are increasing capital spending by a 17% clip



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International Business

fellow at the Brookings Institution. "But the Japanese still might have the last laugh. This is Japan adjusting and not Japan coming to the end of its rope."

Evidence to that effect is that none of Japan's leading corporations has yet announced revisions of capital spending plans. That translates into continued strong research as well as more labor-efficient plants in Japan and a broader international reach. In 1989, Japan became the first country since World War II to outspend the U.S. on plants and equipment, laying out a cool \$549 billion to the U.S.'s \$513 billion. DRI/McGraw-Hill economist Milan Brahmbhatt says that when the public sector and housing are included, investment represents 38.5% of Japan's GNP, a postwar high.

To be sure, there is pain ahead for some Japanese companies that still need to raise capital. Take the warrant bond game. In the go-go days, companies could issue bonds with interest rates of 1% or less as long as they were coupled with warrants to buy stock at bargain prices. Investors assumed that stock prices would keep rising. But today, yields on such bonds have shot up over 5%. Nippon Metal Industry Co. is paying 5.375% on a \$70 million warrant bond issued in September. Other companies such as Kao are being forced to sweeten the terms of their equity-linked debt. Such measures "are indicative of how desperate [some] Japanese companies are to raise capital," says Robert J. Sasaki, a trader at Jardine Fleming Securities Ltd. in Tokyo.

Dozens of other companies are giving up on new financing altogether. On Sept. 28, Mazda Motor Corp. suddenly canceled a yen convertible bond issue valued at \$725 million for fear of weak demand, despite the high 5.5% coupon attached. Mazda denies it will have any trouble meeting its \$870 million spending plan for 1990. But it has been more than 18 months since it last tapped the markets, and some worry that future spending—and its ability to keep pace with the likes of Toyota and Nissan—will be threatened. "We never thought the market would get this bad," says Mazda Director Keiichi Yoshikawa.

WEAK LINKS. But analysts expect small and midsize companies, many of which are unlisted and don't have access to the capital markets, to feel the biggest jolt from higher rates. "These companies haven't been raising lots of surplus money in previous years," says Iwao Nakatani, professor of economics at Osaka University. "The effect [on them] will be dramatic."

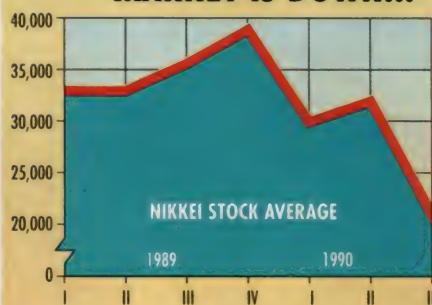
Other losers will be companies that played financial games, which the Japanese call *zaitech*. Men's apparel maker

Taka-Q Co., for instance, boosted its 1989 profits 73% by playing the markets with a \$312 million kitty raised over the past five years. Now that it is losing money on its portfolio, "Taka-Q will take a hit from two sides, because its basic business is not doing well either," says Mariko Kodama, an analyst at rating agency Mikuni & Co.

But for the foreseeable future, the pressure on Japan's big spenders will be slight because they are riding a cushion

higher rates help Matsushita, Toyota, and Hitachi because they raise the earnings from the companies' cash reserves. Although Japanese banks are cutting back on overseas investments, the sheer strength of big manufacturers might allow them to continue expanding even if the U.S. and Europe tilt into recession. In the semiconductor crunch of the early 1980s, for example, "they kept increasing capacity right through the recession," says Dick K. Nanto, head of the

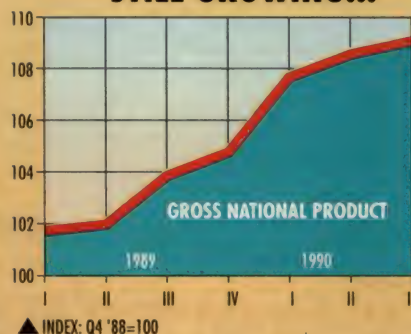
JAPAN'S STOCK MARKET IS DOWN...



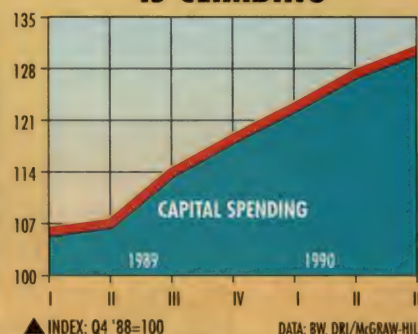
...AND INTEREST RATES ARE UP...



...BUT THE ECONOMY IS STILL GROWING...



...AND BUSINESS SPENDING IS CLIMBING



of \$190 billion in equity that was raised during 1989. "The issue for these companies is not funding costs but profit opportunities," says Akio Mikuni, president of Mikuni.

In some senses, the money game is still tilted in Japan's favor. Nowhere is this clearer than on the Tokyo stock exchange. Although stock prices have taken a beating, price-earnings multiples are still high: At 32, they're more than twice the average ratio of Standard & Poor's 500 stocks. And even though borrowing costs are up from 5.4% one year ago to 8% now, that's still about two percentage points lower than the borrowing rates for U.S. corporations. "The relative advantage is still very much with Japan," says James C. Abegglen, president of consulting firm Asia Advisory Service Inc.

In fact, higher interest rates could help the big get bigger. On a net basis,

Congressional Research Service's Japan Task Force. "At the end of the recession, they were the only ones with new capacity and stood to gain market share."

What gives Japan added maneuvering room is that it has dramatically expanded its domestic market and carved out a much broader presence throughout East Asia, the world's fastest-growing region. Japan's foreign investments also have given it a measure of insulation from the vagaries of currency swings and protectionism. "Unless the U.S. goes into a very severe recession, a small decrease in net Japanese exports to the U.S. will not pull them into recession," says Kanto. If that's true, Japan's toughest companies will continue their march. Japan's much-vaunted capital edge may have been narrowed, but to embattled competitors, it may no longer matter.

By Ted Holden in Tokyo

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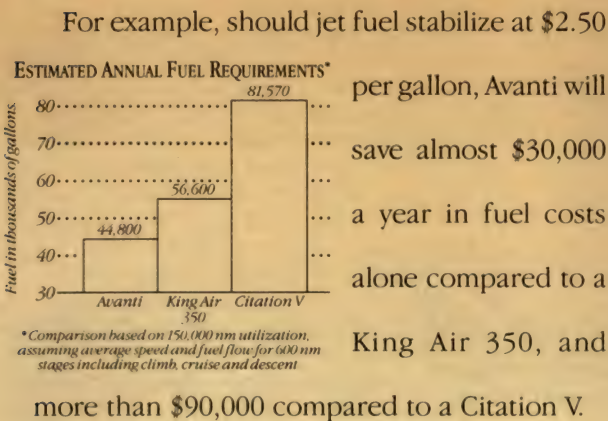
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IRAN IS MAKING THE MOST OF BEING THE LESSER OF TWO EVILS

Emerging from the Persian Gulf crisis as the U.S.-Iraq standoff continues is a surprise winner: Iran. After years as an international pariah, Iran is suddenly being courted both by Iraqi President Saddam Hussein and by his Western and Arab adversaries. Iranian President Hashemi Rafsanjani is deftly playing both sides for political and economic gains.

From Baghdad, Rafsanjani is wringing a highly favorable settlement of the 1980-88 Iran-Iraq war. Saddam is giving up everything he fought for, including sole control over the strategic Shatt-al-Arab waterway. In his Aug. 15 acceptance of Rafsanjani's peace terms, Saddam even opened the way for Tehran to seek reparations. "Everything you wanted... has been realized," Saddam wrote.

At home, Rafsanjani's hard-nosed role in managing Iraq's capitulation is a boost in his political struggle against anti-Western radicals. In the Rafsanjani-Saddam letters that Tehran has since published, Rafsanjani comes across as tough and shrewd while Saddam sounds increasingly desperate.

EUROPEAN THAW. While squeezing concessions from Iraq, Rafsanjani is also fast improving Iran's relations with Europe. On Sept. 27, he scored a major coup by persuading Britain to renew diplomatic relations. The British were so eager to ensure Iran's observance of U.N. sanctions against Iraq that they didn't press Rafsanjani to withdraw the late Ayatollah Khomeini's death threat against author Salman Rushdie, which caused the rift. The warm-up with Britain should clear the way for European credits and technology to help rebuild the war-devastated Iranian economy. In the first major long-term Western loan to Iran in years, France's Société Générale agreed on Sept. 5 to raise \$1.8 billion to finance three petrochemical projects.

Rafsanjani, who has staked his career on improving the economy, is also reaping the windfall from higher oil prices.

With crude at \$30 per barrel, Iran would earn \$27 billion a year, compared with the \$15.4 billion estimate in its current budget. An Iranian businessman predicts that Rafsanjani may soon win Parliament's approval for stepped-up investments.

Rafsanjani has also been able to cozy up to the conservative Arab states, long estranged by Iranian radicalism. In New York on Sept. 29, Foreign Minister Ali Akbar Velayati hosted a dinner for foreign ministers of the Saudi-led Gulf Cooperation Council, who were attending U.N. meetings. The Saudis say they will consider easing limits on Iranians making the pilgrimage to Mecca that were imposed after rioting in 1987.

Gary Sick, a Columbia University Iran specialist, predicts Tehran may also get economic aid from the gulf states.

SMOKESCREENS. Rafsanjani knows, of course, that all these gains could be lost if Iran were caught seriously violating the sanctions against Iraq. That is why most observers doubt recent reports that Iran intends to swap food for Iraqi oil. "That would be crazy," says Vahe Petrossian, a London-based Iran expert. However, Iran can't afford to be seen taking America's side in starving fellow Moslems. So Tehran will put up occasional smokescreens of anti-American rhetoric.

Such outbursts, and the continued holding of American hostages by Tehran-linked Lebanese groups, mean that Iran's ties to the U.S. will not warm up as fast as those with Europe. "Relations with Iran are likely to improve with a whimper rather than with a bang," says Anthony H. Cordesman, national security aide to Senator John McCain (R-Ariz.).

U.S. officials also urge wariness of a resurgent Iran if Iraq is defeated militarily. With a population of 56 million, the region's biggest by far, Iran could replace Iraq once again as the gulf power to watch out for.

By Stanley Reed in New York, with Marilyn Achiron in Cairo, Amy Borrus in Washington, and Ruth Pearson at the U.N.



RAFSANJANI: COURTED BY EUROPE AND IRAQ

GLOBAL WRAPUP

MEXICO

President Carlos Salinas de Gortari is already looking beyond the proposed free-trade agreement with the U.S. to a role for Mexico as an economic bridge between North and South America. A free-trade pact signed with Chile on Oct. 3, providing for elimination of all tariffs between the two countries within three years, is a first step toward that goal. The accord is expected to spur exports of Chilean fish, forest products, and farm produce to Mexico, and of Mexican auto parts and other manufactures to Chile. Such exchanges are feasible because Chile and Mexico have already moved fur-

ther toward market economies than other Latin American countries. Now, Colombia and Venezuela are also discussing free trade with Mexico.

Compared with its huge trade with the U.S., Mexico's economic ties with the rest of the hemisphere have been minuscule up to now. But eventually, Salinas hopes, investments from the U.S., Japan, and Europe, combined with low labor costs, will make Mexican industry increasingly competitive. The result could be a growing role for Mexico as a supplier of manufactured goods to other Latin American countries and a customer for their products—as well as a gateway between North and South.

ISRAEL

Jerusalem will now let Washington keep closer tabs on Israeli settlements in the West Bank in return for \$400 million in new U.S. loan guarantees to house Russian immigrants. Israel yielded to a U.S. demand for periodic reports on housing outlays and is expected to ask for even bigger guarantees to cope with an immigrant tide that may total 400,000 in 1991.

Only a few hundred settlers, including Russians, are expected to relocate this year in the West Bank, where around 75,000 Israelis now live. But Washington fears an Arab backlash if the influx into the West Bank rises.

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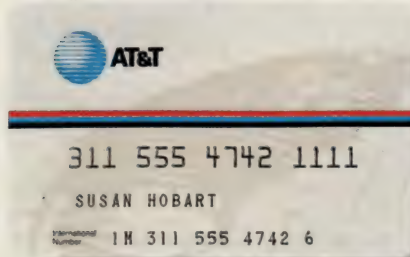
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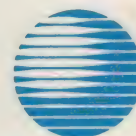
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'I HAVE MY PLANS, AND I HAVE MY VISIONS'

Janet Holmes à Court means to run the family holdings

They called him The Great Acquirer. Flouting convention and ignoring reputation, Robert Holmes à Court became, for a time, the richest man in Australia. His audacious corporate raids once struck fear in the hearts of chief executives everywhere. Now he's gone, dead of a heart attack at age 53 on Sept. 2. Into his shoes steps an executive with a markedly different style. Understated and down-to-earth, the new boss of Heytesbury Holdings Ltd. is anything but a rabble-rouser. She is Janet Holmes à Court, his wife.

True to the Holmes à Court style, she has quickly made her mark. Before Robert was even buried, his 47-year-old widow gathered 40 top staffers in the company's Perth headquarters for a meeting. There, the new chairman

vowed to continue building the conglomerate. "I have my plans, and I have my visions, and I want to achieve them with you," she told them during a brief address. Listeners say her speech brought some employees to tears.

But many wonder if Holmes à Court's abilities will match her resolve. She has long been active behind the scenes as Robert's confidante and was Heytesbury's deputy chairman. Company insiders describe her as highly intelligent and professional. And outside the family company, Janet has a reputation as a capable administrator through her work for educational groups and various charities. But running Heytesbury, a sprawling conglomerate with \$660 million in assets (table), is a far bigger task than anything she has ever done. Australia's

largest landowner, it has 32,000 square miles of pastoral properties that serve as grazing land for 320,000 head of cattle and about 70,000 sheep. Heytesbury also has extensive interests in Thoroughbred horse breeding, with stud farms in Australia and New Zealand.

In Britain, Heytesbury owns the Stoll Moss chain of 13 London theaters. It also owns 6.6% of Andrew Lloyd Webber's Really Useful Group PLC. Holmes à Court had hoped to use that stake to wrest control of Webber's Palace Theater. In a venture with French oil giant Société Nationale Elf Aquitaine, Heytesbury owns 5% of British agribusiness group Dalgety PLC. And in the U.S., it has a small stake in copper miner Cyprus Minerals Corp. Last year, Heytesbury reported earnings of \$7.5 million.

'HANDS-ON.' Some analysts in Australia suggest Janet may be a figurehead, but Heytesbury executives say that's not the case. "She is an active, hands-on chairman," says Derek Williams, CEO of Heytesbury's British operations. "To describe her involvement mainly as a sort of cheerleader or PR adviser understates the position considerably."

Still in mourning, Holmes à Court has said nothing publicly about whether she intends to part with any of Heytesbury's holdings. Company insiders say she feels a sentimental attachment to all the properties and is unlikely to make any moves she believes her late husband would not have made. But gone, almost certainly, will be the former chairman's highly profitable share-trading activities, which often resulted in his receiving greenmail. This fiscal year, Holmes à Court booked a \$21.5 million profit on the sale of a stake in auction house Christie's International PLC. Whether Heytesbury could continue to prosper without such profits is a major question.

To some inside the company, a downsizing seems inevitable. Heytesbury has already been approached about selling the theaters, although the offer was rebuffed. And the chairman is unlikely to expand the company's media interests. Robert was fascinated by the media and toyed with becoming a major newspaper owner. In the months before his death he was buying up \$5 million in junk bonds issued by John Fairfax Group Ltd., the debt-laden media conglomerate. But Janet, who deeply resented the treatment her husband often got from newspapers, is said by insiders to have no interest in the press. She and Robert met at the Uni-

HEYTESBURY HOLDINGS

Janet Holmes à Court has taken the reins at a company with assets worth about \$660 million. An overview:

DALGETY PLC Its 5% stake of this British food group, shared through a joint venture, is worth \$76.5 million

GLENPRAIRIE CATTLE RANCH Situated in Rockhampton, Queensland, it's valued at \$6.6 million

HEYTESBURY STUD It includes three stud farms in Australia and one in New Zealand, home to about 180 horses

REALLY USEFUL GROUP PLC A 6.6% stake in this British entertainment group controlled by Andrew Lloyd Webber is worth \$10.2 million

21 SOHO SQUARE, LONDON Site of Heytesbury's British headquarters, for which it paid \$27.6 million last year

STOLL MOSS THEATERS Heytesbury owns 100% of this chain of 13 theaters in London's West End

YOUNG RIVER STATION This sheep-and-cattle property in Esperance, Western Australia, is valued at \$6.6 million

DATA: BW



HOLMES À COURT: LONG ACTIVE BEHIND THE SCENES

An aerial photograph of a golf course green. The green is uniquely shaped to resemble a bottle of Absolut Vodka, complete with a neck and a wider body. The green is surrounded by a dark, dense line of trees. Several sand traps are visible on the green, including one in the 'neck' area and two in the 'body' area. A golf flag is positioned near the bottom of the bottle shape.

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HERESY IN THE CANCER LAB

Biochemist Bruce Ames insists some carcinogens aren't so deadly

versity of Western Australia, where he was studying law. He was debonair and a hit with women, former classmates say. By all accounts she was a brilliant student, majoring in organic chemistry, with a high profile in university politics. Her style was not as flashy as Robert's, but she was striking in looks, energetic, and admired for her intelligence. They were married in 1966, and Janet worked for three years as a science teacher. Although she raised four children, now ranging in age from 17 to 22, tending to Robert may have been her toughest assignment. For years she acted as his driver, secretary, clerk, and cook. In an interview, she once described her role as "dogsbody."

A RAIDER'S RISE. Robert saved his energies for becoming a tycoon. Over two decades, the South African-born financier built his empire and his reputation around two main operating companies—Bell Resources and Bell Group Ltd. By the mid-1980s, at their zenith, the companies controlled worldwide interests worth nearly \$5 billion. In the U.S., the raider won notoriety through his acquisition and sale of large stakes in Texaco Inc. and USX Corp. But his empire was battered in the October, 1987, stock-market crash. Holmes à Court sold his Bell Group interests to archrival Alan Bond, who has since run into serious financial problems of his own.

Throughout his climb, Janet was deputy chairman of Heytesbury, a private holding company Robert formed early in his career. Just how much influence she had is unclear. She kept an office at the company and came in almost daily. Some insiders say Janet's chief activities were administrative matters such as approving expense claims. She made her strongest mark in activities unrelated to her power-hungry husband. During her four years as chairman of the Australian Children's Television Foundation, for instance, the nonprofit group has created several award-winning programs—and even turned a profit. She still chairs the organization and is also deputy chancellor of her alma mater.

Robert's death was apparently a crushing blow for Janet. The day after he died, she published a short note in the local paper. "My darling Robert, Thank you for 24 fantastic years and four wonderful children. You had such courage, wit, style, compassion, and integrity," it read. "Goodbye to my best friend." Fay Gale, vice-chancellor of the University of Western Australia, thinks the couple's closeness will help Janet in her new role. "She had an intimate understanding of the empire that he was building," says Gale. Translating that understanding into action will be the trick.

By Stephen Hutcheon in Sydney, with bureau reports

It is with some trepidation that you meet Bruce N. Ames over lunch. The bespectacled scientist is best known for exposing such innocuous ingestibles as peanut butter and comfrey tea as carcinogenic time bombs. Sure enough, in a restaurant near his University of California at Berkeley lab, Ames notes that the espresso he is sipping has "more carcinogens than you'd get from pesticide residues in a year." Yet he isn't trying to ruin the meal. "Do what your mother told you," he says. "All things in moderation, and eat your vegetables."

It has taken the 61-year-old biochemist a lifetime of research, 250 scientific papers, and more than a dozen prestigious awards to state those conclusions with confidence. Over the past decade, in fact, he has become convinced that regulators, with the best intentions, have overreacted to the dangers of pollution and chemical exposure and have underrated risks from natural substances. As a consequence, Ames argues, the government should stop its expensive program of testing for, and ridding the environment

of, minute traces of pollutants. That stance has made him a media celebrity—and a heretic in environmental health science. And now, an opinion column published in the journal *Science* is raising the clamor to new levels.

Ames's latest pronouncement, co-authored by colleague Lois Swirsky Gold of

Lawrence Berkeley Laboratory, is that using rats to predict the risk of cancer is a "bankrupt" approach that should be abandoned. The scientists analyzed thousands of studies that used megadoses on rodents to see if cancer occurred. Combining this with data on cell damage, they concluded that the huge doses of chemicals, not their inherent tendency to damage DNA, prompt tumors.

That has added fuel to a heated debate over how best to test for cancer-causing chemicals (box).

UNNATURAL CAUSES. Ames's reasoning sounds logical. He argues that humans and animals have evolved mechanisms for processing low levels of carcinogenic natural substances that work just as well for synthetic ones. The body con-



AMES: MEGADOSING RATS IS POINTLESS

SOME OF THE SURPRISING SOURCES

Biochemist Bruce Ames's HERP scale measures carcinogen hazards from natural sources that may worry most about trace chemicals in drinking water, other common expo-

EXPOSURE	1 liter of polluted water	Cooked bacon (100g)	1 peanut butter sandwich
CARCINOGEN	Trichloroethylene	Nitrites	Aflatoxin
RISK*	0.004%	0.003%	0.03%

*The HERP Index relates human chemical exposure to doses that cause cancer in rodents

stantly repairs minor damage done to DNA by natural assaults. But Ames thinks that the huge doses of chemicals given to rodents overload their defense mechanisms. He therefore dismisses the results of such tests and labels unnecessary the efforts to get rid of trace amounts of pesticides in drinking water or on vegetables. "We're diverting resources to trivia," he fumes. Better, he argues, to use the tens of millions spent each year on such testing to fight well-known cancer risks such as smoking and high-fat diets.

ONE MOLECULE. It's a startling turnaround for someone who burst on the scene in the mid-1970s as a darling of environmentalists. In those days, Ames believed that just one molecule of a foreign agent posed a danger. He pioneered a lab test to determine whether chemicals caused DNA to mutate, making them potentially carcinogenic. A fire-retardant chemical called Tris that was used to coat children's pajamas was pulled off the market in 1977 when it flunked the "Ames test."

But in the early 1980s, scientists began putting natural chemicals, such as those found in broccoli, through his test. They, too, caused DNA to mutate. So Ames developed a scale called HERP, for "human exposure/rodent potency," to rank the dangers of natural and synthetic chemicals based on both animal tests and human exposure. It indicated that the unpronounceable chemicals showing up in drinking water were often less hazardous than the natural agents people eat, drink, and breathe (table).

Since humans were actually living longer, Ames decided that his worry about single molecules was unfounded. In fact, he concluded that at low levels, most chemicals are probably safe. The chemical industry cheered, at least indirectly. Says Byron E. Butterworth, a scientist with the Chemical Industry Institute of Toxicology in Research Triangle Park, N.C.: "Bruce Ames has always been on the side of good science."

That isn't what Ames's former fans are saying. They contend that the HERP index is flawed, particularly in compar-

ing exposure to carcinogens in dried squid, for instance, with those in contaminated water or air. One involves a voluntary act, they note, while the other doesn't. Late last year, in a blistering review of Ames's work, *Consumer Reports* called his conclusions "simplistic." Janet Hathaway, staff attorney for the Natural Resources Defense Council in Washington, dismisses Ames's statements as "useful for a chemical industry embarrassed about the use of its products." Counters Ames: "Environmentalists get more members by selling fear."

But environmentalists aren't Ames's only critics. One highly placed National Cancer Institute researcher insists that abolishing rodent tests would leave the public at risk: "What are we going to do, wait to count tumors?" Richard Griese, who directs the toxicology division for the National Institute of Environmental Health Sciences, concedes that animal tests have flaws. But he says Ames is a lone voice advocating that they be shelved. "There's little data to support his view," he adds.

Still, Ames argues that as basic science uncovers more about cancer—he cites recent research in cell proliferation at the University of Nebraska—his position is being reinforced. He also dismisses the irony of his about-face: "People have the funny notion that scientists are certain about everything," he says. "Any good scientist has to change." And don't try painting him as a industry tool: Ames claims never to have taken a penny from industry, and does no consulting. He never patented the Ames test, which is still used in hundreds of labs.

A 'HOBBY.' Indeed, Ames's world revolves around science. He and his wife, Giovanna Ferro-Luzzi Ames, a Berkeley biochemistry professor, live close enough to campus to walk to work together. The door of his cluttered cubbyhole office is plastered with toxicology humor. "Health nut so scared of food additives," shrieks a tabloid headline, "he starves to death." Ames even describes his foray into environmental health as a "hobby." His serious work involves deciphering how damage to genes and cells contributes to aging and cancer.

Ames's arguments remain to be proven. But right or wrong, they underscore how little scientists know about the effect of chemicals on health. Even critics concede that a dearth of good data hampers efforts to rank risks. Until that changes, you can always hedge your bets: Avoid suspected carcinogens. And listen to your mother.

By Joan O'C. Hamilton in Berkeley, Calif.

HOW ACCURATE ARE THOSE TESTS?

For 40 years, scientists have known that pesticides, solvents, and other chemicals can cause cancer. The problem is proving the link. With rare cancers, it's relatively easy. But with common ones, pinpointing the contribution of any one of thousands of causes is a herculean task.

That's where lab animals come in. Since harmful chemicals can't be tested on humans, rats and mice bear the brunt. But it might require thousands to pick up even a high 1-in-1,000 cancer risk at the low levels people are exposed to. By the mid-1970s, scientists had a new method: zapping rodents with massive doses. Many got cancer in tests of everything from the sweetener cyclamate to the pesticide Alar.

SKewed results? But now, many toxicologists see flaws in those tests. The mathematical models used to extrapolate from animal to human data don't consider the human body's ability to repair DNA or the power of the human immune system. Substances that cause cancer in rats, for example, aren't necessarily potent human carcinogens—and vice versa. Also, there's some evidence that massive doses skew results: When doses are lowered and the number of animals increased, which theoretically should prompt the same number of tumors, the correlation breaks down. "We don't like the test results," notes Ernest E. McConnell, a Raleigh (N.C.) toxicology consultant.

Few scientists may agree with University of California at Berkeley biochemist Bruce N. Ames that high-dose animal tests should be junked. But the problems do have regulators in a quandary. Support is growing for a halt on relying only on animal tests to calculate cancer risks. But if regulatory agencies disclaimed them, chemicals identified as cancer-causing in the tests could be approved—and "there would be blood all over," says McConnell.

Scientists are optimistic that medical advances will eventually help identify cancer risks more precisely. Genetically altered rodents called transgenics, which better mimic human responses to foreign chemicals than natural animals do, show great promise. Still, it may take "25 years before we get it right," says Michael Gallo, a member of the National Academy of Sciences' Committee on Risk Assessment Methodology. Until then, massively dosed rats may be the next-best bet.

By John Carey in Washington

OF CANCER RISK

ral and man-made chemicals. While the public sures carry more danger, he says.

1 raw mushroom	Wine (250 ml)	Phenobarbital (1 sleeping pill)
Hydrazines	Ethyl alcohol	Phenobarbital
0.1%	4.7%	16%

DATA: BRUCE AMES

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Commentary/by John Carey

HOT FUSION IS BURNING DOLLARS—AND LITTLE ELSE

From the moment physicists began to ponder the idea in the 1940s, generating power with nuclear fusion—the same reaction that powers the sun—has held the promise of unlimited clean energy. But fusion has one other property: The more scientists learn about it, the more elusive it is.

In 1951, fusion pioneer Lyman Spitzer predicted a fusion power plant within five years. Seven years later, Amasa S. Bishop, head of the nascent federal fusion energy program, said that “with ingenuity, hard work, and luck,” the U.S. could build a full-scale

So perhaps Watkins and Congress should look at fusion more realistically—and put it on the back burner.

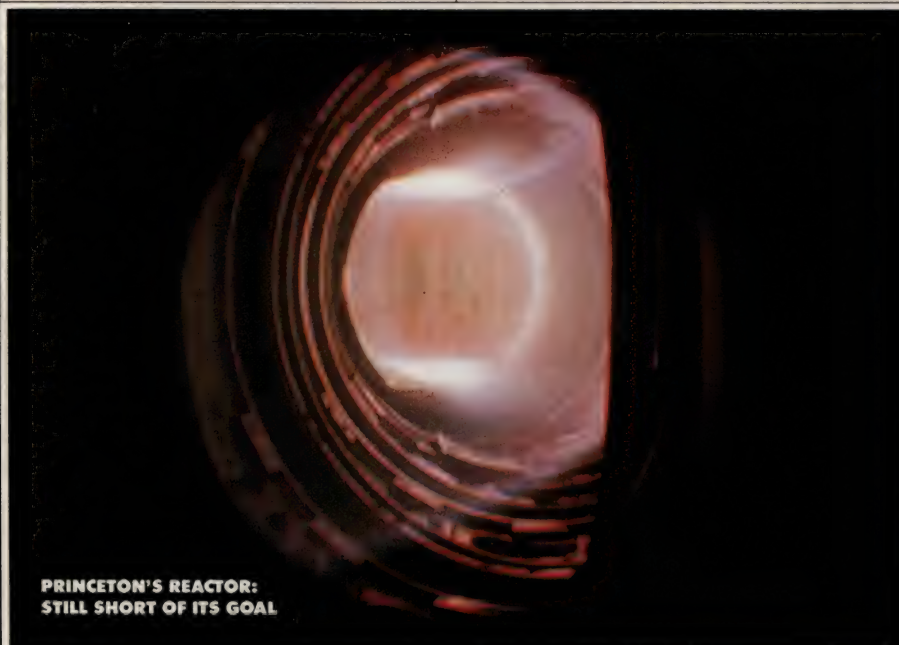
What makes this decision so hard is the undeniable appeal of fusion power. Unlike today's nuclear fission plants, which make power by splitting the atom, fusion reactors would turn matter into energy when two atoms—typically, some form of hydrogen—fuse. This reaction itself produces no hazardous radiation. And its fuel can be as common as water. With fusion, says Edson C. Brolin, acting director of Princeton Plasma Physics Laboratory,

fusion reaction becomes self-sustaining. In today's experimental reactors, scientists must continually inject huge amounts of energy to force atoms to fuse. The new device, which would be built at Princeton University, would reach ignition by heating the fuel to hundreds of millions of degrees.

It would all be a great idea—if Washington had money to burn and fusion were just around the corner. But neither is so. In the next few months, magnetic fusion test reactors at Princeton and Abingdon, England, will probably reach a milestone known as “scientific breakeven.” That's when the energy produced by fusion finally equals the amount of energy needed to heat the fuel. But breakeven is just a small step beyond what scientists can do now, and is mainly a way to drum up financial support. The really crucial milestone is reaching ignition, where scientists won't have to continue pumping in huge amounts of heat to keep the reaction going. Current machines can't reach ignition. And many scientists worry that it may be difficult even in future machines because the fuel may act unpredictably.

SPEWING NEUTRONS. Another barrier to be surmounted is fusion's environmental effect. Unfortunately, the process isn't as clean as advertised. While the reaction itself doesn't produce radiation, it does spew out neutrons, which turn almost any material radioactive. A recent congressional Office of Technology Assessment study estimated that the walls of a fusion reactor would have to be replaced every 5 to 10 years—though they would be much less radioactive than a fission plant's waste.

It might make sense to preserve the inertial-fusion budget, since it helps pay for Defense Dept. bombs. But it is harder to defend increases for magnetic fusion. In August, a National Academy of Sciences committee concluded that the U.S. would get more energy for its buck by improving conservation, exploring solar power, and making fission processes safer. “If we really want to make energy in the next 30 years,” says California Institute of Technology physicist Steven E. Koonin, “fusion's not going to do it.” Washington should put its money into something that will.



PRINCETON'S REACTOR:
STILL SHORT OF ITS GOAL

fusion reactor “within a decade or two.” In 1971, Bishop's successor, Robert L. Hirsch, foresaw a demonstration plant by 1995. Now, guess what? Reporting to Energy Secretary James D. Watkins on Sept. 27, a high-powered advisory committee suggested hiking the fusion energy budget to build a demonstration plant by 2025 and a commercial reactor by 2050. “People have been saying, ‘Fusion is 30 years away—and always will be,’” says University of Maryland physicist Robert L. Park. “Except now, it seems to be 60 years away.”

In fact, there's no guarantee that even this prediction will come true. After 40 years and some \$20 billion spent worldwide, no one is close to making electricity from tiny, man-made suns.

“the top two inches of Lake Erie contain 1.6 times more energy than all the world's oil supplies.”

The Energy Dept. panel, led by H. Guyford Stever, a former National Science Foundation director, proposed nearly doubling funding for magnetic-containment fusion—in which fuel is held in a magnetic field—to \$620 million by 1996. It also called for a steady increase in the \$161 million budget for inertial-confinement fusion, which uses lasers to fuse atoms—in effect setting off tiny H-bombs.

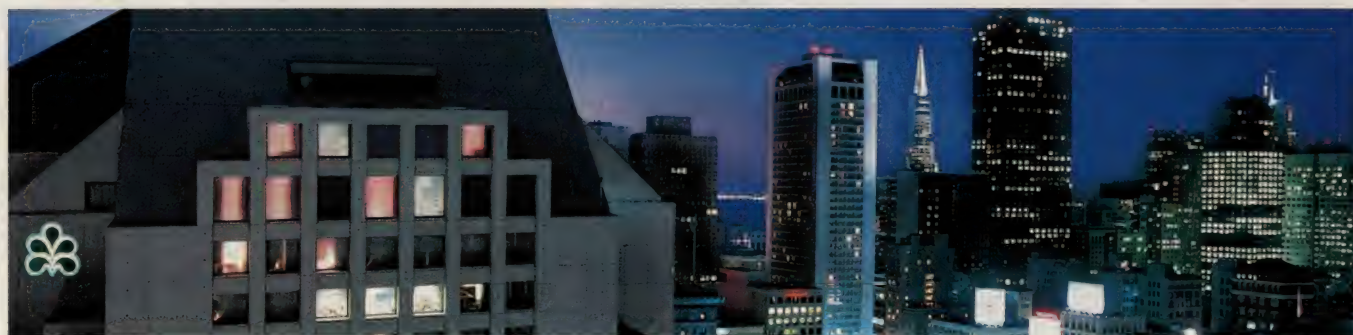
This money would buy a strong basic research program, a role in designing an international reactor to test engineering problems, and a new U.S. machine to explore the uncharted physics of ignition—the point at which the



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Joan Appleton spends

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weeks of travel time.

three weeks

"That's life in this part of the world," she shrugs. "I'm basically an outdoor girl. I love fresh air and open spaces. But if I have to spend that much time underground, I'd like it to be as comfortable as possible."

underground.

She and her fellow passengers also appreciate punctuality as much as comfort; trains that run on time and don't get stuck somewhere along the line. Which, as Joan will tell you, hasn't always been the case. Europe's largest urban population is served by the world's oldest metro system, and it sometimes shows.

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Developments to Watch

EDITED BY ROBERT BUDERI

A MAGIC BULLET TO COUNTER BIOLOGICAL WEAPONS



While U.S. troops in Saudi Arabia pack special clothing to fend off chemical weapons, Tran C. Chanh at the Southwest Foundation for Biomedical Research in San Antonio is closing in on a vaccine to combat another threat—biological warfare.

The immunologist has created a protein that mimics the fatal

yeast toxin T-2, a biological poison that causes organ failure by halting the body's protein production. Injection of the decoy toxin, it is hoped, would force the body to create a defense against the poison, eliminating the need for protective gear. The idea might also be used against other kinds of bacteria or viruses. So far, Chanh's research, which is backed by the U.S. Army, has been conducted only on mice. Human studies are at least five years away, he estimates. In the meantime, Chanh is also researching vaccines against weapons such as nerve gas.

REINVENTING THE LIGHT BULB —BY SLASHING INFRARED OUTPUT

America is on a recycling rampage: newspapers, cans—and now light. A halogen lamp from General Electric Co. "recycles" the infrared (IR) light humans don't see but feel as heat. It uses the trapped energy to provide more visible light.

Infrared light accounts for 75% of a typical bulb's output. But GE's Halogen-IR bulb cuts the amount released by a third. A quartz tube within the bulb is coated with a special reflectant and shaped to focus the IR light back onto the filament—which burns hotter and produces more high-energy "usable" light. In late September, a commercially available floodlight version of the lamp won an award for new technology from *Research & Development* magazine. It not only outperforms a standard halogen lamp but is also 60% more efficient than normal incandescent lamps. At a cost of about \$8, GE figures the lamp should save some \$14 during its 2,000-hour lifetime. Researchers are now working to put the tube into household-shaped bulbs. They expect success within two years.

SPEEDIER SURGERY ON WORN-OUT ARTIFICIAL JOINTS

Hip replacement is a traumatic but widely successful option for patients crippled by fractures or congenital defects. Unfortunately, 40,000 implants must be replaced each year because artificial joints loosen. That leaves surgeons with an onerous task: chipping out the old cement holding the joint in place. It can take hours—and is especially dangerous for elderly patients whose bones have been weakened by osteoporosis.

Now comes the Cement Extraction System from Origin Medsystems of San Mateo, Calif. The reasoning is simple: Cement adheres best to cement. So Origin's kit contains new cement, which bonds to the old stuff. Surgeons then use a

stainless steel rod to pull both old and new cement out in small plugs. The company has booked some 500 orders since the \$1,500 kits hit the market last March. Not only does the system reduce the risk of fracture, it cuts at least an hour off surgery time—a tidy savings, since operating rooms can run \$60 a minute. The shorter time also lowers the risk of infection and fluid loss. And it allows surgeons to perform more procedures each day.

COLD FUSION: SCIENTISTS MAY BE GETTING WARMER

In March, 1989, the University of Utah rocked the world by claiming that chemists had produced nuclear fusion on a laboratory table. Most scientists remain skeptical, but that doesn't mean the idea of cold fusion and cheap, nonpolluting energy is dying. It may just require powerful atom-smashing-type equipment instead of a simple electrolytic cell.

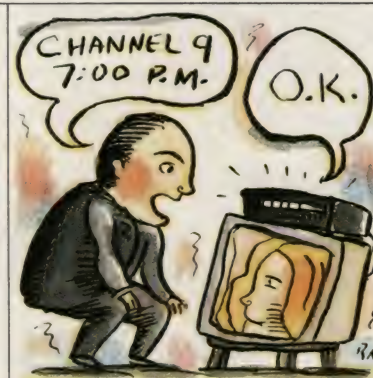
An international research team, led by Brigham Young University physicist Steven E. Jones, has nursed this alternate type of cold fusion for a decade. Now, Japan's Institute of Physical & Chemical Research, armed with a \$12 million government grant, is joining Britain's Rutherford Appleton Laboratory to back the effort. The goal: to coax deuterium atoms into fusing by loading them down with muons. Muons are like electrons, only 200 times more massive. So if they replace the electrons orbiting deuterium atoms, gravity will pull the atoms together. When they fuse, the muons will be kicked out to catalyze more reactions. Each muon must trigger 500 such fusions to liberate more energy than is used to create them in the first place. Jones is up to 150, but the Rutherford lab is designing a new pulsed generator that should double the fusion rate, bringing cold fusion much closer to reality—Jones guesses by 1993.

AT LAST, IDIOT-PROOF WAYS TO PROGRAM VCRs

Despite all the fancy features on today's VCRs, many are used just to play back movies. That's because viewers can't figure out how to record. Now, solutions to this problem are emerging on both sides of the Pacific: Next spring, Matsushita Electric Industrial Co. will launch a voice-programmable VCR. And a California startup has a way to greatly simplify programming.

The Matsushita VCR has a remote-control unit complete with speaker and microphone—and asks for recording information orally. The spoken response is confirmed on a tiny screen. But talk isn't cheap. The VCR will cost up to \$200 more than standard models. And so far, it understands only Japanese.

Meanwhile, Gemstar Development Corp. in Pasadena, Calif., plans to offer VCR Plus, a \$60 universal remote control that makes programming painless. Instead of setting the recording time and day, viewers just enter a five-digit code that will run in newspapers alongside every TV listing. VCR Plus will be sold by many electronics retailers starting in November. Codes will pop up about the same time in most major newspapers.



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to integrate information

so you're free to integrate Unisys

so flexible you're
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Unisys. A framework you freedom.



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CEO ROBERT LOUIS-DREYFUS: COUNTING ON NEW BUSINESS TO BUOY THE SUNKEN SHARES

CAN LOUIS-DREYFUS KEEP SAATCHI'S HEART AND SOUL?

If he can't appease bondholders, one of its ad giants may have to go

It was a deal worthy of Robert Louis-Dreyfus and his reputation for financial alchemy. The chief executive of Saatchi & Saatchi PLC would move his prestigious flagship advertising agency to the new Canary Wharf office complex in London's dilapidated Docklands. In return, Olympia & York Developments Ltd., the powerful Canadian developer behind the project, would arrange an investment of as much as \$95 million in financially strained Saatchi.

But the plan collapsed in mid-September. O&Y's owners, the Reichmann brothers, under pressure themselves, concluded that Saatchi was a bad risk. For Saatchi, the failed deal is a severe blow to an effort to repair its finances. Without the investment, Louis-Dreyfus still has the daunting task of restructuring the company before his major investors and bankers force him to do what was until recently unthinkable: sell off one of Saatchi's two huge ad networks—Saatchi & Saatchi Advertising Worldwide or Backer Spielvogel Bates Worldwide Inc.

Among several options he is considering: attracting an equity investor or issuing new shares.

Saatchi's fall from grace started when its founders, Maurice and Charles Saatchi, used its once high-flying stock to fuel an acquisition spree. The result was a stable of unwanted consulting firms and half a billion in debt. After the brothers installed Louis-Dreyfus as CEO last January, the unflappable Frenchman trimmed the debt to \$389 million

through asset sales and tighter financial controls. He also forced out several Saatchi cronies, while the brothers accepted supporting roles. Still, analysts predict that pretax earnings for the fiscal year ended Sept. 30 will drop about 50%, to \$55 million. But excluding the consulting units and interest payments brightens the picture: The operating income of the ad networks dipped only 5%.

SUFFOCATING DEBT. Not bad—but it hasn't been nearly enough. The company's stock was trading in London at \$4.86 when Louis-Dreyfus took the helm. Now, it's down to penny-stock levels, closing at a recent 68¢. "The market is saying the probability of bankruptcy is 50/50," says Brian Sturgess, an analyst at Barclays de Zoete Wedd Ltd. in London. Investors fear that softening ad markets will impede Saatchi's effort to pay down more of its suffocating debt.

A special bond issue puts Louis-Dreyfus in his most painful quandary yet. If he can't raise the stock price to \$9.88 a share by mid-1993, he must pay holders of Saatchi convertible bonds \$400 million in cash—which he doesn't have. "This worries us," says a Saatchi banker. "We would like them to get rid of that bullet." That puts the pressure on Louis-Dreyfus to find a new equity investor or other source of capital. Otherwise, the stock will continue to languish.

Even though the possible \$400 million payment is still nearly three years away, some financial cleanup is needed sooner because of the insidious effect investor uncertainty is having on Saatchi's core ad business. "Companies have said: 'Until the cloud passes at the parent, we don't want to consider a Saatchi & Saatchi agency,'" says Backer Chairman Carl Spielvogel. At flagship agency Saatchi & Saatchi in London, Chairman Bill Muirhead had to issue an internal memo on Sept. 25 to deny a rumor that the company was going out of business. And in New York, Edward L. Wax, CEO of Saatchi & Saatchi Advertising Inc., says the parent company's difficulties make it difficult to offer attractive financial incentives to top staffers.

Louis-Dreyfus figures he still has 18 months to raise money—possibly for a partial cash payment to induce bondholders to lower the exercise price of \$9.88 on the 1993 bonds and push the conversion date back. But some bankers think that in the rapidly worsening investment climate, he has much less time to act. Otherwise, he could be forced to break up the company. One of the bankers in the 20-bank syndicate that ar-

THE SAATCHI FIRE SALE

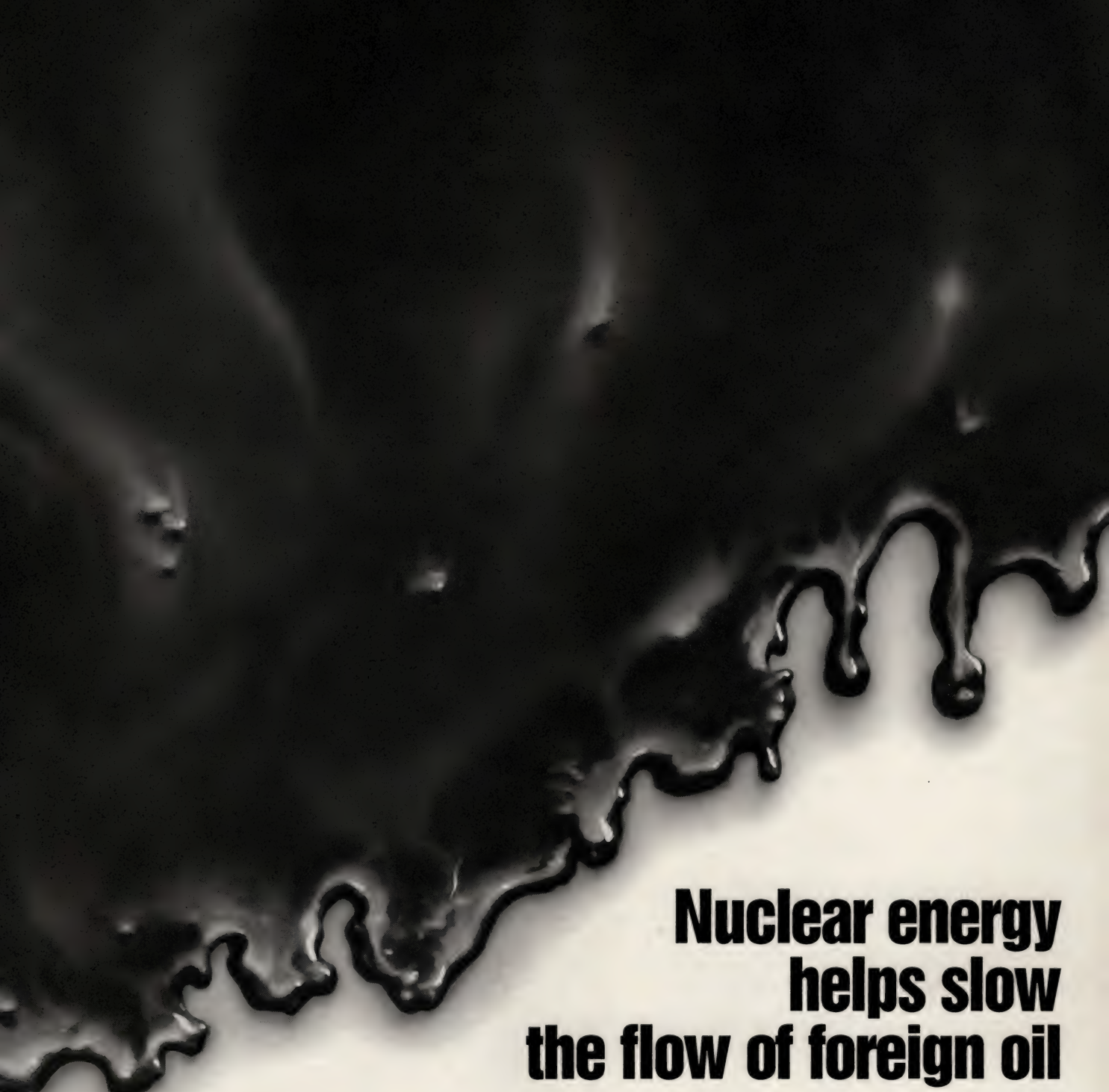
Here are the major consulting subsidiaries that Saatchi & Saatchi has been selling back to managers since June, 1989:

Subsidiary	What Saatchi paid	What it got
	Millions of dollars	
CLEVELAND CONSULTING ASSOCIATES	\$5.5	\$5.2
INFORMATION CONSULTING GROUP	31.0	12.0
HAY GROUP	132.0	75.0*
PETERSON & CO.	123.0	-3.0**
GARTNER GROUP	85.0	PENDING

*\$65 million up front, \$10 million of payment deferred over 10 years

**Took a \$3 million loss after writing off intercompany loans

DATA: COMPANY REPORTS; GOLDMAN, SACHS & CO.



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*1990 Second Quarter Buyers Study by Consumer Attitude Research, C.A.R. classification: Large Luxury.

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than every Cadillac and every Lincoln in its class.***

— Second Quarter Buyers Study by Consumer Attitude Research.

Some cars take years to establish their credentials for superior quality. If they ever do. Chrysler engineers so scrupulously prepared the Imperial that by the time of its launch into the real world it was ready to make its reputation for high quality at once. Against all the traditional American luxury cars in its class.

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Chrysler was able to change the standards by which American luxury cars are judged for one very simple reason: We obviously live by higher standards.

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Marketing

ranged a \$450 million loan earlier this year says that selling one of the main agencies "has crossed every banker's mind" but hasn't been pressed yet.

Louis-Dreyfus has no sentimental ties to the agencies. Before coming to Saatchi, he turned around a medical-data company, IMS International Inc., and promptly departed when it was sold. To this professional fixer, even the London agency, which Maurice and Charles started in a basement in 1970, may not be off-limits to bidders.

PALTRY TAKE. But Louis-Dreyfus is adamant that a public auction makes no sense in a distressed market. As evidence, he points to the paltry amounts realized from the decision by Saatchi's previous management to sell its consulting firms (table). When they were first put on the block in mid-1989, the company predicted sales of up to \$500 million. Now, with most of the eight firms sold, the take is more like \$170 million, even with deferred payments, and Saatchi has written off as much as \$190 million.

So Louis-Dreyfus needs the discipline



A BRITISH AIRWAYS AD: PLAUDITS FOR THE FLAGSHIP

of a high-wire artist: He must keep scrambling for more capital while resisting the temptation to take any more fire-sale prices. Last month, for example, he rejected a "single-digit" management-buyout bid for corporate image consultant Siegel & Gale Inc. Several months ago, he quietly entertained proposals to buy Backer. Nothing has come of the talks, but one potential buyer, France's Eurocom, says it's still interested.

Louis-Dreyfus is relying on the resil-

ience of his ad agencies to weather the current downturn and start snaring new business. The London agency tops the list of new-business winners among British shops. It has also won plaudits for its British Airways PLC campaign, which assembled a cast of hundreds in the Utah desert to celebrate world unity. Saatchi's New York agency is also on an upswing. But Backer's U.S. operation has lost accounts worth \$125 million, including Prudential Insurance Co. and Xerox.

The agencies' strength makes some observers guardedly optimistic. Says Alan J. Gottesman, an analyst at PaineWebber Inc.: "It's like looking at a guy cut open on the operating table. You wouldn't pick him to be on your team, but six months from now, he might be a whole lot better."

Louis-Dreyfus insists that his costs are under control and sees real improvement. "I'm still convinced we can pull through if people support us," he says. With a worsening advertising climate, that support will be sorely needed.

By Richard A. Melcher in London and Mark Landler in New York

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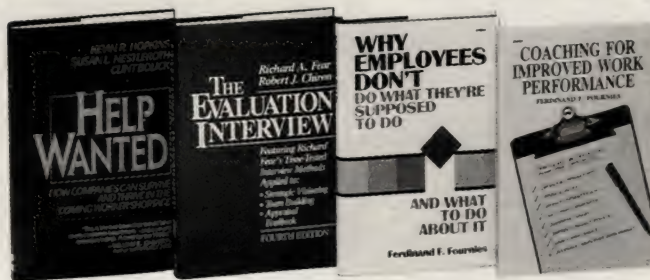
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HOW FUJITSU HELPS A BIG HOSPITAL STAY SMALL.

Saint Cloud Hospital in central Minnesota is a regional medical center serving a population of more than 425,000 in a ten-county area covering more than 7,500 square miles. It's a highly progressive, rapidly expanding institution with hundreds of doctors, comprehensive services, and an attitude of intense human concern. Patients are never numbers, they're people. And they are treated like people. For all its size, Saint Cloud Hospital still feels 'small'.

CARING INTIMACY

The hospital has worked very hard to ensure an environment of caring intimacy, developing many special programs and procedures and investing heavily in technologies that free its people to focus on people.

One current investment is in hundreds of portable and mobile cellular telephones to give the hospital instant two-way communications with its on-call staff. The phones have put doctors and nurses in touch as never before, and have begun to find a wide range of unexpected uses for themselves—like letting emergency room patients reassure loved ones directly from a moving hospital gurney.

SELECTED FUJITSU

Saint Cloud Hospital, working with its service provider, United States Cellular, studied a variety of cellular telephone

brands before it finally settled on Fujitsu. It chose Fujitsu not only for the quality of its telephones but for the quality of the company behind them. Fujitsu is one of the world's largest computer and communications companies—a high-tech powerhouse that's a major force in the global information revolution. With 115,000 employees, projects completed in a hundred countries, and manufacturing facilities across the U.S.A., it's a company that's many things to many different people. To the people at Saint Cloud Hospital, it's a giant that's helping them stay small.



Gary Gibson of Fujitsu talks with Bill Becker of Saint Cloud Hospital and Joe Salaski of United States Cellular Mobile Telephone Network. United States Cellular, a nationwide carrier which operates the cellular network in St. Cloud, Minnesota, strongly recommends Fujitsu phones. For information call Fujitsu at (214) 690-6000.

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AUDI FINALLY GETS SOME TRACTION

Its leasing program is luring back U.S. drivers—but not profits

Desperate times often call for desperate measures. Executives at Audi of America Inc. watched in dismay as charges that their cars were prone to sudden, uncontrolled acceleration drove U.S. sales from a 1985 peak of 74,241 cars to a woeful 21,225 in 1989. In a last-ditch effort to halt the slide, they launched a generous new leasing program and free-maintenance offer.

The moves appear to have finally brought Audi's skid under control, pushing car sales for the first eight months of 1990 some 6% ahead of a year earlier. But the price has been high. Despite the increasing sales, the costly incentives—combined with the weak dollar—will likely keep Audi's U.S. operations in the red this year. And the company's profits could suffer even worse damage

when the leases expire years from now.

Still, Audi had little choice but to take a chance. Press reports of wildly accelerating Audis, such as the one that allegedly ran amok and killed a six-year-old Akron boy in his own driveway with his mother at the wheel, tarred the company as a maker of unsafe, unreliable cars. A National Highway Traffic Safety Administration (NHTSA) investigation last year exonerated Audi, blaming the incidents on drivers who inadvertently hit the gas instead of the brakes. But Audi's own research confirms that consumers still consider its cars generally unsafe. The bad publicity "hurt us, and hurt us badly," says Richard L. Mugg, a longtime marketing executive at Audi's U.S. parent, Volkswagen of America Inc. He became head of Audi of America in 1988.

Even though the U.S. accounts for just 5% of Audi's sales, Volkswagen has a lot riding on an Audi comeback. Squeezed by Japanese competitors, U.S. sales of Volkswagens sank from a 1970 peak of 570,000 to just 128,000 last year. But with baby boomers moving into their prime earning years, sales of larger luxury models, such as Audis, will likely swell to about 1.6 million cars in the mid-1990s, up from 1.4 million today.

PAMPERED. With its offer of attractive short-term leases and free routine maintenance on all new Audis, the company hopes to persuade drivers to climb back into its cars. The leases, which Audi calls "three-year test drives," require no downpayments, compared with the hefty 10% to 20% some luxury cars demand. And the monthly payments sharply undercut the competition. Leasing a \$31,000 Audi 100 costs about \$500 a month, compared with about \$700 a month for a \$33,000 BMW 525i. Audi picks up the tab for all routine maintenance, right down to oil changes and new wiper blades, on both leased and purchased cars for three years or 50,000 miles. The program "is a great way of restoring confidence," says Ronald S. Loshin, president of Bank Lease Consultants Inc. in San Leandro, Calif.

The leases are starting to bring drivers back. Two years ago, 20% of Audi's U.S. car transactions were leases. Now, 44% of its new cars are leased, compared with just 25% for BMW. But they're likely to hand Audi a loss on its U.S. sales of about \$7 million this year. And the sharpest sting from the leasing program could come when the leases end. At that point, the company has to take back and resell the used cars. Ominously, Audis have the highest depreciation

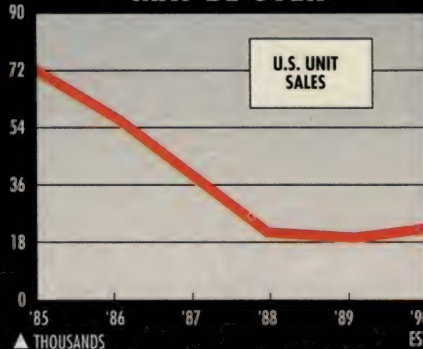


HILVERDA IS COUNTING ON THE QUATTRO

AUDI'S QUALITY IS UP...



...AND ITS SALES SKID MAY BE OVER



DATA: J.D. POWER & ASSOCIATES, WARD'S AUTOMOTIVE REPORTS INC.

rate among imported luxury cars. A four-year-old Audi is worth only about 25% of what it cost new, compared with 45% to 50% for a Mercedes-Benz. Audi executives say upgrading quality will improve resale results and prevent losses on the tail end of the leases.

RETURN CUSTOMERS. Audi is taking the risk in hopes that leasing customers will be so happy that they'll choose an Audi next time. In fact, Audi's customer satisfaction has improved markedly since 1985 (chart). And customer loyalty is on the upswing, too. One-quarter of the people who traded in late-model Audis recently drove away in new ones. That compares with just 10% of those who traded in 1985 Audis. Audi's quality, once notoriously poor, has improved, too. The number of defects in Audis has declined 26% in the past three years, according to a survey by California-based J.D. Power & Associates Inc. Still, the entire industry is improving, leaving Audi's quality no better than average.

Audi is also improving its safety image. When the NHTSA smashed a 1990 Audi 100 into a wall at 35 mph, the air-bag-protected mannequin in the driver's seat recorded the lowest damage ever in such crash tests. The passenger mannequin came out rather worse for the experience, but Audi says it will offer passenger-side air bags by the mid-1990s. Four-wheel drive is available on all Audis, and antilock brakes are standard on all but one model.

To lead Audi's new marketing charge, the company named a new marketing manager, Ben A. Hilverda, on Sept. 1. Hilverda, a 42-year-old former market researcher at General Motors Corp. who joined VW in 1977, plans a new ad campaign starting in January that will emphasize Audi's German engineering. Hilverda will have a slew of new products to tell drivers about. One, the \$42,400 turbocharged 200 Quattro, which leaps to 60 mph in 6.5 seconds, debuts this fall. Hilverda expects the car to bolster Audi's image as a maker of performance sedans. Next year, Audi will introduce a redesigned six-cylinder version of its basic sedan, the five-cylinder model 100. A convertible and a fuel-efficient, all-aluminum sedan are planned for around 1993. Hilverda says he expects the efforts to boost sales to 45,000 to 50,000 cars by the mid-1990s.

Of course, every major carmaker wants a chunk of the lucrative U.S. luxury market. And the race is only getting tougher as the Japanese, with their Acura, Lexus, and Infiniti models, are taking a chunk out of such once-invincible European cars as BMW and Volvo. With its high-risk, high-cost effort to lure back customers, Audi is only buying itself a slot at the starting gate.

By David Woodruff in Detroit



STONE CALLS CONSOLIDATED-BATHURST "AN IDEAL FIT"—EVEN AT \$2.2 BILLION

SUDDENLY, STONE CONTAINER FEELS BOXED IN

It made its biggest buy at peak market. Now, it may be overleveraged

It seemed Roger W. Stone couldn't miss. Using Drexel Burnham Lambert Inc.'s clubby junk-bond network, the chairman of Stone Container Corp. spent \$1.8 billion on four acquisitions in the mid-1980s to transform a sleepy paper company into the world's largest producer of corrugated boxes and paper bags. His strategy made splendid sense: During cyclical downturns, he snapped up troubled U.S. competitors at cut-rate prices using borrowed money. When business rebounded, Stone quickly worked down debt to a reasonable level—and hunted for the next trophy.

Then, the acquisitive Stone became taken with Consolidated-Bathurst Inc., a \$2 billion Canadian newsprint and paper-products maker with extensive European operations. Stone was lured by the prospect of getting into Europe before trade barriers are eased in 1992 and of boosting his company's position in the newsprint business. He borrowed \$2.7 billion—more than triple the amount of earlier deals—to buy the company in March, 1989. Yet Stone made his move not as the newsprint industry was in a slump but just as it hit its peak. "It did depart from the pattern," admits Stone. "But it was an ideal strategic fit."

Perhaps. But for the moment, the deal places the \$5.8 billion parent in a financial jam. Almost as soon as the Consolidated-Bathurst deal closed, the paper

business plunged into what could be a prolonged downturn. Stock analysts and rivals believe Stone paid too much to buy into newsprint, a business he had little experience in. The company is now highly leveraged just as prices for its key product lines are tanking and cash flow is drying up. Stone has responded by trimming staff, slashing capital expenditures, and raising prices on key paper products. But the company may yet come up short of cash to service its debt. "There's very little room for error," warns Nelson Noel, a credit analyst with Moody's Investors Service Inc.

STEEP PLUNGE. No wonder Stone's investors are starting to feel closed in. The company's stock has lost 57% of its market value so far this year, a far steeper plunge than either the 35% decline in paper stocks overall or the 38.6% drop in the Standard & Poor's 500-stock index. Cash is tight, and interest coverage is razor-thin (chart, page 83). That's why Moody's has just downgraded a big chunk of its debt. And some on Wall Street wonder about Stone's ability to make principal payments on the \$3.6 billion in long-term debt belonging to the company and its subsidiaries, about 22% of which consists of high-interest junk-bond debt. Stone insists the company has "adequate" cash and credit lines to deal with the load.

Still, investors were hardly reassured



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in September, when Stone was forced to postpone a \$200 million junk offering because of weakness in the junk market. Nor can investors find much solace in Stone's first-half profit plunge of 44%, or the anemic earnings it's likely to post for the year—an outlook that has attracted short-sellers.

How did Stone stumble so badly? "Clearly we were overconfident," says Sidney Davidson, a University of Chicago accounting professor who retired from Stone's board in May. "We made a decision that at least in the short run seems to have been wrong." Adds Henry G. Van der Eb, retired chairman of rival Container Corp. "Roger Stone might wish he hadn't reached so far."

He says he doesn't. But then, Stone has been reaching almost all his life. Growing up in a prosperous part of Chicago's South Side, he wasn't content just rooting for the White Sox at Comiskey Park—he fantasized about owning the club, friends say. That dream hasn't come true yet. But he has done well running the show at his Chicago-based company: Earnings grew at a compound annual clip of 34% last decade.

Stone certainly displayed his drive in going after Consolidated-Bathurst,

known informally as Connie. In 1988, he first approached Paul Desmarais, chairman of Power Corp. of Canada, an investment holding company that owned a 40% interest in Connie. The two came close to a deal for Power's stake, but Desmarais hoped to merge with a Canadian rival. In the end, though, Desmarais sold a 10% stake to the Kuwait Investment Office in mid-1988 and sat tight.

'NONSENSE.' Undeterred, Stone made a second pass at Connie in early 1989. This time, recalls William I. M. Turner, Connie's chairman at the time and still a Power director, Stone seemed "anxious" to make a big Canadian acquisition. "He had a lot of successes up to that point in buying companies," Turner says. Stone offered \$2.2 billion in cash, a 50.4% premium over the market value. Connie immediately accepted the bid.

Stone dismisses criticism that he was overeager as "utter nonsense." But he admits that he missed signs of the impending market downturn. Perhaps his biggest misstep was assuming that the price of newsprint would continue to climb. Since the deal closed, newsprint prices have fallen from about \$600 a ton to below \$580. Stone also acknowledges



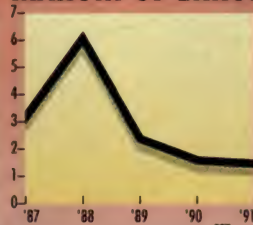
A NEWSPRINT MILL AT CONSOLIDATED: THE INDUSTRY

that Connie was an unusually expensive acquisition. In his past four deals, he has generally bought paper mills and other assets for a price that represented about 20% of their replacement cost. For Connie's assets, that figure is more like 45%.

*"When Tom died, I just went numb.
Then I panicked. I knew we had
life insurance—I wrote the checks."*

*"But with the kids in college,
I figured things would be pretty tight.
Was I surprised?"*

STONE'S SHRINKING MARGIN OF ERROR



▲ RATIO OF CASH FLOW TO INTEREST EXPENSE

DATA: COMPANY REPORTS, OPPENHEIMER & CO.

roughly in line with the 11-to-1 ratio Georgia-Pacific Corp. dished out for its acquisition of Great Northern Nekoosa Corp. in June.

Still, Stone probably could have landed Connie for considerably less had he waited for the downturn in the newsprint and paper market. Indeed, Stone executives say Connie's income and cash flow have fallen far short of the levels they anticipated when Stone borrowed heavily to complete the deal.

STOPPING THE SLIDE. Worse, Stone's principal business is under pressure. The price of linerboard—the main material used to make corrugated boxes—has faded from its 1989 peak of \$410 a ton to about \$360. Linerboard and corrugated boxes represent about 60% of Stone's total sales.

That's especially troublesome given Stone's current balance sheet. The company's debt load is about 71% of its total capitalization. Cash flow, which amounted to six times debt interest costs in 1988, is down to a 1.6 multiple now. Stone needs to cut capital expenditures quickly, sell off assets, or stretch debt payments, figures Oppenheimer & Co. analyst Gary Palmero. Otherwise, he projects, the company could face a cash-

flow shortfall of up to \$325 million this year, when it has to meet a total debt-service burden of about \$718 million.

Stone isn't dawdling. In July, he quietly instituted a hiring freeze, letting staff numbers dwindle through attrition. He's selling off noncore assets and slashing capital spending by 8%, to \$550 million this year. More substantial cuts are likely in 1991. Stone is also trying to stop the slide in newsprint prices. With one of Connie's major Canadian rivals shuttering 60% of its newsprint capacity because of a union strike, Stone recently announced a 5% price hike effective Jan. 1. But there's no guarantee that the hike will stick next year, with recession fears in the U.S. and Canada.

So far, there has been no talk of cutting dividends. That's good news for the founding Stone family, which controls 28% of the stock and gets \$12 million a year in dividend payouts. And the company still has some financial flexibility, with about \$600 million in credit lines. Still, Stone certainly doesn't have much wiggle room. And his decision to depart from an acquisition strategy that served him so well over the last decade will be felt for years to come.

By Julia Flynn Siler in Chicago

CHART BY ALBERTO MENA/BW

MAY BE AT THE START OF A PROLONGED DOWNTURN

All the same, Stone notes that Connie has given the company a stronger footing in the faster-growing European paper markets. And Stone says he and his investment banker didn't miscalculate. They paid 11.2 times Connie's earnings,

"I had no idea the policies would've gone up so much in value. They even helped me open this place."

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6 2nd place company

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APPLE: NEW TEAM, NEW STRATEGY

CAN THE SCULLEY-SPINDLER PARTNERSHIP DELIVER THE BOOST THAT'S NEEDED?



SPINDLER: TRYING
TO REPEAT HIS
SUCCESS AT
APPLE EUROPE

ED KASHI

When Michael H. Spindler found himself thrust into the No. 2 spot at Apple Computer Inc. last January, he knew there would be no time for an executive honeymoon. Apple's market share was dropping fast, investors and customers were griping, and workers, buffeted by continual churning in the executive suite, were demoralized. So when 260 Apple managers gathered last month to hear the company's turnaround plan for 1991, they were eager to learn what Chief Operating Officer Spindler had to say. "There was a show-me attitude," says one attendee.

They were shown. Pacing back and forth on a hotel stage near San Francisco International Airport, Spindler mapped out his strategy. It was not the usual sugarcoated pep talk. Instead, the fast-talking German, with his mop of unruly black hair, rattled off a detailed plan for regaining market share and paring Apple's bloated costs. The audience lapped it up. Later, Apple Chairman and CEO John Sculley warmly congratulated Spindler on his 10th anniversary with the company and gave his latest lieutenant a diamond-studded Apple logo pin. The audience jumped to a standing ovation.

BREATHING ROOM. Now, Spindler just has to convince the world outside of Apple's Cupertino (Calif.) headquarters that his plans can work. And he doesn't have much time. Nearly seven years after its launch, the Macintosh is rapidly losing its edge as the easy-to-use personal computer. The short-term remedy is straightforward: new Macs with lower price tags, more advanced software, and price cuts on older models. If the market responds favorably to the new line, Apple will get the breathing room it needs to pursue a more critical, long-term strategy: a replacement for the Mac. But "if Apple doesn't recover in 1991, its chances of recovery thereafter become hopelessly small," warns Peter J. Rogers, a computer analyst with Robertson, Stephens & Co.

Rapid recovery is by no means a sure thing, given Apple's slide. Its share of the \$42.3 billion U.S. personal computer market has plunged from nearly 15% three years ago to an estimated 9% now (chart, page 88). By last winter, "U.S. sales were dead in the water," admits Sculley. Luckily, European and Pacific Rim sales stayed bright: Apple's international business posted growth rates of 28% in the first half. Even so,

APPLE'S FALL LINEUP

MAC CLASSIC

Aimed at first-time buyers, the Classic comes with a black-and-white, 9-in. screen, one floppy-disk drive, and 1 megabyte of memory. It uses the Motorola 68000 microprocessor of the original Mac. With more memory and a hard-disk drive, the price is \$1,499. The Classic replaces Mac Plus and SE

AVAILABLE OCT. 15

\$999

MAC LC

LC stands for low-cost color. Until now, color Macs started at \$6,316. "Elsie" uses the 68020 chip and crams 2 megabytes of memory, a hard-disk drive, and one expansion slot in a "pizza-box" package. This is Apple's bread-and-butter business computer—to go up against IBM's best-selling PS/2 Model 55SX

AVAILABLE OCT. 15

\$3,098
WITH COLOR MONITOR

MAC IISI

Apple's stab at high power at a relatively low price, the IISI uses the 68030 chip, Motorola's answer to Intel's 80386. The IISI comes with 2 megabytes of memory, but can be upgraded to 17, and 80 megabytes of disk-drive capacity. Eventually, it will displace the SE 30, which, for now, will get a big cut in price

AVAILABLE JANUARY, 1991

\$3,769

when results are in for the fiscal year ended Sept. 30, analysts expect Apple to report an anemic 6% revenue gain, to \$5.5 billion. That's a jarring slowdown from 1989's 30% pace. The profit picture is worse. Rick J. Martin, an analyst at Prudential-Bache Securities, projects a puny 2% increase in net earnings, to \$465 million. That prospect has helped push Apple stock down to below 30, off 37% from mid-July.

RADICAL CHANGE. Spindler will soon find out if his plan works. On Oct. 15, the company will launch its low-priced Macs: the \$999 Mac Classic, the \$3,000 Mac LC equipped with a detachable color monitor, and the powerful \$3,700 Mac IISI (table). They will be followed next year by a high-end Macintosh, a new laptop, and a rewrite of the Mac's basic software (page 93)—all intended to win back Apple's technological lead. These projects were in the works long before Spindler arrived in Cupertino, but he's responsible for getting them into production and on the market.

The new Macs represent a radical change—and risk. Although the first Macintosh in 1984 was billed as "the computer for the rest of us," its progeny have become the computers that only well-heeled corporate customers—or die-hard Apple worshipers—can afford. By this spring, Macintoshes cost as much as 36% more than comparable IBM and Compaq machines. That was part of an intentional drive to exact a steep premium for Macintosh's distinctive "user-friendly" features. The resulting high gross margins—about 25% greater than those of other PC makers—were needed, Sculley said, to fund the research needed to keep the proprietary Mac ahead of the IBM PC and its clones.

There was, of course, a downside. Apple's original customers—schools and small businesses—found it harder to afford new Macs. And, Sculley now concedes, fewer and fewer new customers were willing to pay the premium to buy their first Macintoshes. At the same time, the whole proprietary approach on which Apple based its high-price strategy was being called into question by so-called open systems. Those computers, based on standardized software, promised low hardware costs and easy interconnections.

By 1989, it was clear that Apple had gone too far. Even Mac fanatics—the intensely loyal customers who eagerly await the next permutation of the Macintosh design—began to question Apple's pricing. And the technological advances that were promised in return for the

Cover Story

'This is still a teenage company. It's a \$5 billion company with the corporate infrastructure of a \$250 million company'

ROBERT PUETTE
President, Apple USA



ing consultant says she advised the company long ago to make feature-for-feature comparisons between the Macintosh and the IBM machines. Even with its premium prices, she says, "Mac still comes out ahead in a lot of things that people really care about, particularly ease of use." But Apple marketing executives rejected the idea and insisted on a more nebulous "image" campaign.

That's not Spindler's game. "You can't make style win over substance," he says. In a 24-year career

in computers and electronics that began in engineering and then moved into sales and marketing, the 47-year-old held jobs at Siemens, Intel, and Digital Equipment before joining Apple Europe. While capable of waxing about the "vision" of the Macintosh and the "mission" of Apple, Spindler is firmly grounded in reality. An energetic, hard-driving executive—nicknamed "the Diesel" by colleagues at DEC—he's the antithesis of New Age, touchy-feely Silicon Valley managers. "I wish I had half the turbo he has for a mind," says Sören Olsson, former vice-president of Apple's Northern Europe operation and Spindler's replacement as the Paris-based head of Apple Europe. "Give him a white board and pen, and his mind, mouth, hands all work at the same speed."

high prices were slow in coming. In that single year, Apple's slice of the U.S. market dropped by 20%. More alarming, as 1990 dawned, Microsoft Corp. was getting ready to release Windows 3, the IBM PC program that promised to finally match the Mac's big advantages.

UNLIKELY SWITCH. By the time the warning bells went off, Apple's top management was in disarray. A 1988 reorganization had created largely autonomous empires in marketing and product development under two ambitious executives, Allan Z. Loren, president of Apple USA, and Jean-Louis Gassée, president of Apple products. Fighting between the two camps had left both largely out of touch with the market: Loren's pricing and merchandising policies were a flop, and Gassée's products were late and overengineered. In January, Sculley forced the resignation of Loren. In February, Gassée quit after his responsibilities had been pared. Spindler, the star performer who had propelled Apple's European operations to \$1.2 billion in annual sales from \$467 million in three years, was made COO.

Now, Spindler is set to win back market share. But there's a chance he may be too late. Windows 3 is off to a roaring start: Analysts estimate that 1 million copies have been sold since May. That, say some industry watchers, makes it far harder for Apple to switch IBM PC users to

the Mac. "Nobody who uses a PC will buy a Mac, and nobody who uses a Mac will buy a PC," says Philippe Kahn, president of software maker Borland International Inc.

It needn't have been that way. In 1987, Apple was handed what many analysts figure was a once-in-a-lifetime opportunity. OS/2, the operating system with graphics capability introduced by IBM and Microsoft Corp. in 1987 to give IBM personal computers and their clones Mac-like characteristics, was not selling. As far back as 1987, software developers had urged Sculley to quickly produce cheaper Macs to expand the market while the competition was becalmed. "The Mac is wonderful. But it was too expensive to reach new buyers," says J. A. Heidi Roizen, president of software developer T/Maker Co. Rather than seize its chance to grab market share, however, Apple chose to maximize its

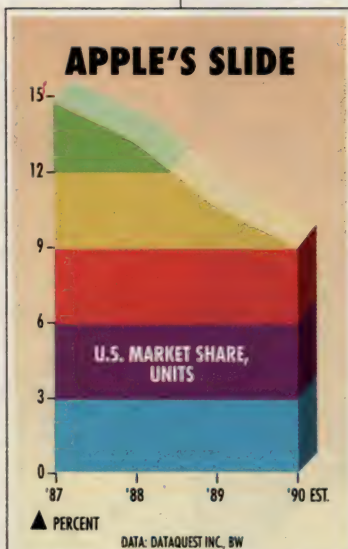
profits. And management gaffes such as overpaying for memory components and excessive spending often wiped out the benefits of Apple's high margins (chart, page 89).

Apple may have also overlooked another opportunity. Even though the Mac's features were unique, the company's marketing avoided making direct comparisons with rival machines. Instead, ads emphasize intangibles such as "the Macintosh advantage" without detailing what it really is. One market-

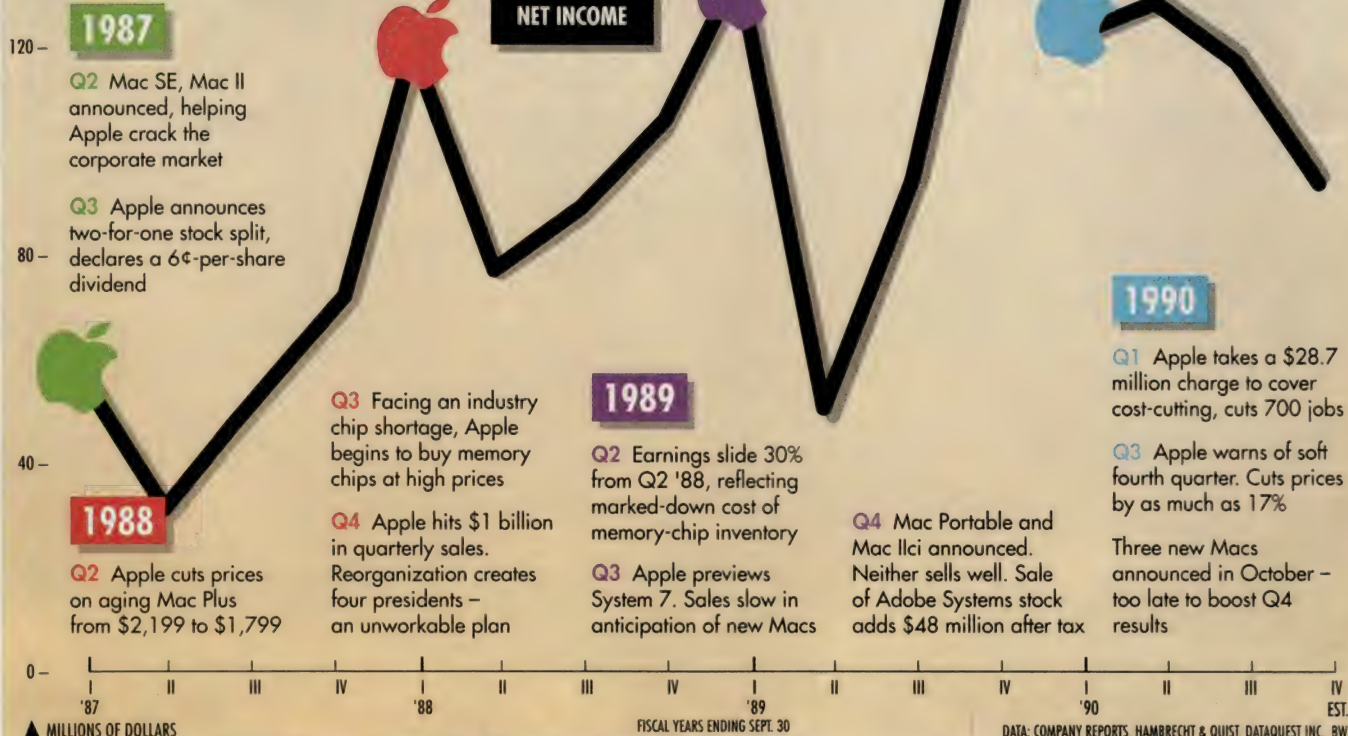
reer in computers and electronics that began in engineering and then moved into sales and marketing, the 47-year-old held jobs at Siemens, Intel, and Digital Equipment before joining Apple Europe. While capable of waxing about the "vision" of the Macintosh and the "mission" of Apple, Spindler is firmly grounded in reality. An energetic, hard-driving executive—nicknamed "the Diesel" by colleagues at DEC—he's the antithesis of New Age, touchy-feely Silicon Valley managers. "I wish I had half the turbo he has for a mind," says Sören Olsson, former vice-president of Apple's Northern Europe operation and Spindler's replacement as the Paris-based head of Apple Europe. "Give him a white board and pen, and his mind, mouth, hands all work at the same speed."

Since taking on the COO job, Spindler has been working almost without letup. In the January reorganization, Spindler took over sales, marketing, manufacturing, and corporate communications, while Chairman Sculley turned his attention to research and development (page 92). Managers are discovering that under Spindler, substantive marketing is in—as are tighter budgets and firm deadlines—and politics are out. Also gone is the arrogant, not-invented-here syndrome: Apple is now talking to Toshiba and Sony about possibly manufacturing an upcoming laptop Macintosh.

'NO PRIMA DONNAS.' With the company facing such formidable challenges, Spindler is also emphasizing teamwork. In a speech to the troops last March, he warned: "There will be no more prima donnas at Apple." That, insiders say, may be the most important change of all. Sculley, the former PepsiCo Inc.



APPLE'S BUMPY ROAD: THREE YEARS OF UPS AND DOWNS



marketing impresario, masterminded a remarkable revival after taking over from ousted co-founder Steven P. Jobs in 1985. But in 1988, with the Mac selling well to Corporate America, Sculley took off on a sabbatical. At his Maine vacation home, he thought up a disastrous reorganization plan that delegated day-to-day decision-making to four presidents, each responsible for giant chunks of the company. Oversize ambitions led to clashes—mainly the ones between development chief Gassée and U.S. marketing chief Loren. But similar rivalries

echoed throughout the executive suite.

By early this year, middle managers were receiving little direction. "If there was a major failing," concedes Sculley, "it was that the organization was confused about where we were going." Indeed, an in-house survey of middle managers in May turned up dissatisfaction and mistrust of top brass, says a former employee. "It was devastating." Snorts an executive still at Apple: "People were calling the management around here 'Pepsi Light.'"

It didn't take long for Spindler to change that impression. Arriving from Paris in March, he quickly sized up the situation and swung into action. "He plants his fist and says this is what we're going to do," says Burt Cummings, an Apple marketing manager. "It's excellent."

SOREN OLSSON
President
Apple Europe



build Apple's troubled domestic sales division. The same month, he reversed a three-year-old plan to spin off Claris Corp., a software subsidiary. The move guaranteed Apple in-house expertise for future development of networking technologies and System 7, the new Mac software. Working with Sculley, Spindler helped patch up a feud with Adobe Systems Inc., maker of the PostScript software that was key to helping the Mac pioneer the desktop publishing market. Gassée had insisted that Apple develop its own printer-control program, a move that would have eliminated royalty payments to Adobe.

SPENDTHRIFT. But Spindler and Sculley have more in mind than undoing Apple's mistakes. They're preparing the company for a new way of life. As lower-priced Macs hit the market, says Prudential-Bache's Martin, gross margins may tumble as low as 45% by 1993, from a peak of 54% in the first nine months of 1990. News of the upcoming low-margin Macs sent Apple's stock to new lows in early October.

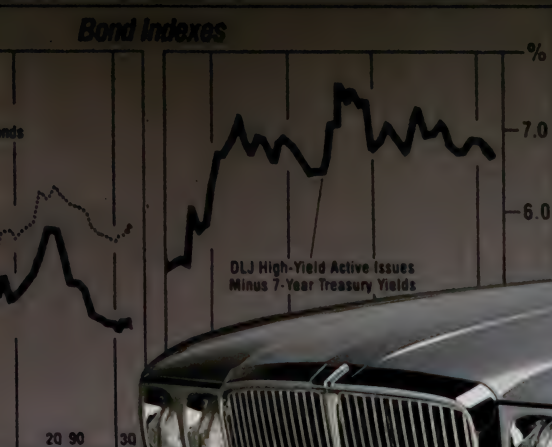
So Apple has to rein in its lavish spending. By computer industry standards, Apple has always been a spendthrift. Its salaries are among the highest in Silicon Valley, and its perks, such as workout facilities, are the best. As a result, its selling, general, and administrative expenses are about 30% of reve-



The 1991 Jaguar It Could Be The Year's Most Signi

	First	High	Low	Last	Chg	%
20 Ind	92.88	93.84	92.42	92.94	- 2.89	- 2.15
10 Ind	94.39	94.48	94.23	94.20	- 2.26	- 2.39
10 Ind	91.55	91.60	91.53	91.53	- 1.73	- 1.89

Advances	35	38	38	38	38
Declines	22	24	22	24	26
Unchanged	16	23	13	20	24
New Highs	4	3	0	0	0
New Lows	3	2	2	6	4
Sales th \$	3,320	3,510	4,380	3,510	3,120



	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
1 1/2% Nike	140	911	20%	13%	14%	14%	14%	14%	14%	14%	14%
1 1/2% Nike	442	1067	15%	8%	9%	9%	9%	9%	9%	9%	9%
1 1/2% Nike	237	755	1-16	1-16	1-16	1-16	1-16	1-16	1-16	1-16	1-16
1 1/2% Nike	788	846	10%	3%	4%	4%	4%	4%	4%	4%	4%
1 1/2% Nike	677	1065	1-16	1-16	1-16	1-16	1-16	1-16	1-16	1-16	1-16
1 1/2% Nike	58	287	5-16	1/2	5-16	5-16	5-16	5-16	5-16	5-16	5-16
1 1/2% Nike	324	468	1	1	1	1	1	1	1	1	1
1 1/2% Nike	594	523	11%	6 1/2	8 1/2	8 1/2	8 1/2	8 1/2	8 1/2	8 1/2	8 1/2
1 1/2% Nike	967	912	2 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2
1 1/2% Nike	963	628	8 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2
1 1/2% Nike	958	466	6 1/2	1 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2
1 1/2% Nike	1644	1096	5 1/2	1 1/2	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2
1 1/2% Nike	157	232	6 1/2	3 1/2	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2
1 1/2% Nike	268	380	1 1/2	1	1	1	1	1	1	1	1
1 1/2% Nike	118	183	33	33	33	33	33	33	33	33	33
1 1/2% Nike	87	574	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2
1 1/2% Nike	141	232	30%	30%	30%	30%	30%	30%	30%	30%	30%
1 1/2% Nike	64	259	9-1	9-1	9-1	9-1	9-1	9-1	9-1	9-1	9-1
1 1/2% Nike	64	259	9-1	9-1	9-1	9-1	9-1	9-1	9-1	9-1	9-1



While it may be impossible to predict the future of the economy with absolute certainty, one thing you can be certain of: At under \$40,000, the 1991 Jaguar XJ6 is priced significantly less than most European luxury motorcars.

And while the XJ6 enjoys certain economic advantages, it also offers the dividend of spirited performance. With 223-horsepower, our sophisticated 24-valve,

four-liter, computer-controlled engine is capable of moving the XJ6 quite rapidly, while a sophisticated independent suspension system and four-wheel anti-lock disc brakes give it outstanding athletic agility.

Further performance refinement comes from a four-speed automatic transmission. Because it's electronically controlled, it converses freely with the engine to determine upshifts and downshifts with unprecedented

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smoothness and accuracy. And by pressing the Sport button, you can program the transmission's shifting pattern for more spirited driving.

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of figured walnut. You will also enjoy such conveniences as computerized climate control and an 80-watt stereo entertainment system that plays through six acoustically matched speakers.

We invite you to test drive the 1991 XJ6. We think you'll see that an economical price can be perfectly compatible with a wealth of luxury and performance. For your nearest dealer, call 1-800-4-JAGUAR.

M A C H I N E



J A G U A R

nues, compared with 24% at Sun Microsystems Inc. For fiscal 1990, analysts estimate, Apple spent a stunning 24% of sales, or \$1.4 billion, on sales and marketing costs, compared with 12% at Compaq Computer Corp. "They haven't been run with the tight financial controls of a Compaq," says Martin. Puette, fresh from the tightly managed HP, says he was blown away by Apple's loose controls. "This is still a teenage company," he says. "It's a \$5 billion company

with the corporate infrastructure of a \$250 million company."

That, too, is changing. Starting with the 1991 corporate business plan, more stringent controls are in place. And planning has become more of a discipline and less of a fantasy. "We started our business planning months earlier than we have before," says Chris Espinosa, a software marketing manager who has been with Apple since it was founded 14 years ago. And "there was a level of

checking and cross-checking that we've never gone to before," adds Guerrino De Luca, a marketing director in Paris.

Puette, who was a running back at Northwestern, is the key player in the 1991 plan. His job is to revive U.S. sales, which have remained dismal despite a series of April price cuts. Puette's first move has been to patch up relations with dealers who fault Apple's lackluster promotional efforts and resent its selling directly to large customers. Apple is

SCULLEY: UP AGAINST THE LAB WALL

John Sculley says that both he and his company thrive on crisis. "Apple works best with its back against the wall," says the chairman. "Believe me, my back has been up against the wall."

That's for sure. Back in 1985, the last time Apple faced a crisis, Sculley had to figure out how to keep the company in one piece following the ouster of co-founder Steven P. Jobs—and how to make the odd-ball Mac a success. To pull it off, he became a spokesman for the company, criss-crossing the globe to convince corporations to buy Macs. Apple took off. Sales swelled from \$1.9 billion in 1985 to \$5.3 billion in 1989. Sculley was well rewarded: At \$2.2 million, his paycheck is one of the highest among CEOs.

But while Sculley was playing Mr. Outside, his senior executives were running amok. Sculley went through a succession of protégés, creating what one former manager calls an atmosphere of "executive *du jour*." By early this year, Apple was once more in crisis.

HIDDEN TALENT. So Sculley installed Michael H. Spindler as his new No. 2 and put him in charge of marketing and most other day-to-day operations. Then, the 51-year-old CEO took on the most important inside job: overseeing development of technology to eventually replace the Macintosh.

It seemed an odd job for Sculley. The former Pepsi-Cola president had been hired to bring big-league marketing savvy to Apple in 1983. And, despite a lifelong interest in technology and his training as an architect, he had never immersed himself in the nuts and bolts of product development. So his decision caused plenty of eye-rolling within Apple's labs. "They really didn't want me," recalls Sculley. Adds Larry

ated a quarterly operations review, and instituted daily 7:30 a.m. meetings with his chief Macintosh engineer. The changes hastened decision-making. Now, "people don't slow each other down," says Tesler.

Sculley's long-term aim is to get new products out the door in 9 months to 12 months, rather than the 18 months to 24 months it now takes. There are signs he is making progress. Just one month short of the Oct. 15 debut of the new Mac LC, and with some manufacturing already under way, Apple quickly reworked the machine's color graphics to meet demands of educational buyers.

Sculley's chief nemesis is what engineers call "creeping elegance"—the tendency to take a perfectly adequate design and keep adding new bells and whistles until the finished product is late to market. Apple had a perfect example in Gassée's Macintosh Portable—an overpriced, overengineered, overweight disaster.

Managing better is one thing. Technology leadership is another. And some engineers fear that Sculley doesn't have the technical depth required to make sure that the Mac replacement is a significant advance. Sculley says he'll continue to devote 70% of his time to R&D until early 1992. Unless, of course, another crisis comes along.

By Barbara Buell in Cupertino, Calif.



There was plenty of eye-rolling in R&D when Sculley named himself chief technical officer. They really didn't want me,' he admits

JOHN SCULLEY
Chairman and CEO



Tesler, vice-president of advanced products: "There was tremendous skepticism among the engineers. I couldn't imagine how he could manage engineering."

But Tesler has been surprised by how well the boss has done. Sculley's big contribution has been to make sense of the various projects launched under Jean-Louis Gassée, the former president of Apple Products. He quickly consolidated development units, cre-

slowly phasing out its major-accounts sales force and turning corporate sales over to local dealers. "This gives us additional credibility with customers," says Steven Asche, director of Apple products at Computerland Corp.

As the new head of Apple USA, Puette is also working to revive sales to schools and colleges, a \$4.2 billion market in the U.S. In the past few years, longtime leader Apple had paid less attention to the market, creating a huge opportunity for IBM. Now, Apple troops are surveying these customers to see what they want in new software and hardware. To get a better grip on the higher-education market, the company has dispatched groups of employees on "camping trips" to universities to pick the brains of students and faculty.

The toughest job in the coming months will be managing the introduction of the new products. "You have guaranteed cannibalism of the machines just above them," says analyst Martin. Already, customers have stopped buying some older models in anticipation of the new Macs, and Apple is likely to cut prices to move inventories. But the company figures that by its second quarter, ending next March, brisk sales of the new models will more than make up the difference. Some analysts say that with recession likely in the U.S., low-priced Macs may be well-timed. "With capital budgets shrinking, price is an important element," says Bruce A. Stephen, director of PC research at International Data Corp. "It will help keep market share from eroding further."

NO MORE MICE. Even if they hold market share—or increase it a bit—the new machines are only a transitory solution. For a more permanent revival, Apple needs to "stay ahead of the power curve" with new technology, says David Bayer, an analyst with Montgomery Securities. Ultimately, the Sculley-Spindler team has to prepare for the day when the Macintosh will be replaced.

Two approaches are now under study, insiders report. One involves computers using the RISC (reduced instruction-set computing) chips that have already brought enormous power to engineering workstations. Apple is said to have 30 engineers working on a project called Jaguar, using Motorola Corp. RISC technology. At least two years off, Jaguar will include extensive video technology and the ability to connect to TVs and VCRs, Apple employees say. The second project is a computer that can deal with handwritten information, eliminating the need for keyboards and mice.

Neither RISC computers nor handwriting-input computers are unique. And that points up Apple's most basic problem: coming up with another computer revolution on the order of the original

MAC'S NEW SYSTEM 7 FACES A STRONG DRAFT FROM WINDOWS

Back in 1984, when Apple Computer Inc. introduced its Macintosh, it was easy to see what made it different. For one thing, its trim physique made it far better looking than other personal computers. More important, instead of just showing words and numbers, as an IBM PC did, the Mac had eye-pleasing graphics. And it came with a device called a mouse that made it possible to do things with a push of a button, rather than typing commands.

What made most of that possible was the Macintosh operating system, the program that controls the computer. In addition to using pictures called "icons" to represent functions, it let owners look at data in two separate files simultaneously by putting them side by side on the screen in "windows." Thanks also to the operating system, all programs written for Mac work similarly, making it easier to learn new ones.

NEW EDGE. Now, after years of trying, other computers have caught up with the Mac. Last May, software developer Microsoft Corp. announced Windows 3.0, a \$150 IBM PC program that mimics the Mac's graphics and windowing features. Industry watchers say that Windows might give the Mac a boost by making graphics more popular.

Mainly, however, Windows is a threat. Realizing that, Apple decided back in 1988 to try to regain the lead with a massive rewrite of its operating system. Called System 7, it is the most extensive software project Apple has attempted since the original Mac. Already a year late, System 7 is due out early next year and will come standard with new Macintoshes. But it will lack some publishing graphics that

Apple had originally planned for it.

Still, Mac owners will get features in System 7 that aren't likely to appear on PCs for a couple of years (table). Better yet, software packages that were written for earlier Mac operating systems will be able to work with System 7. That's a big advantage over the new PC packages, Windows and OS/2, which require new programs to take advantage of their new features. Making System 7 "backwards compatible" has been the major cause of its delay.

The biggest improvement in System 7 is how it helps Macs communicate with different kinds of computers—a

key selling point in corporations. The communications advances are so powerful, says Philippe Kahn, president of software maker Borland International Inc., that "whatever Microsoft gained with Windows, Apple will gain back with System 7."

The problem is that System 7's benefits won't be easy to see, the way the Mac's were in 1984. A Mac and an IBM PC with Windows sitting side by side look alike. Indeed, Windows is so close to the Mac that it has been the subject of a protracted copyright suit between Apple and Microsoft.

Some buyers may also balk at what System 7 doesn't have. It has only a simple form of multitasking, the ability to run more than one program at a time. Complex multitasking is a big feature of OS/2.

Most worrisome, System 7 may not be enough to inspire new software programs for the Mac—particularly when Apple's market share is declining. If that's true, Apple may find that, for all its effort, System 7 amounts to no more than treading water.

By Richard Brandt in Cupertino, Calif.

WHAT'S NEW ABOUT SYSTEM 7

FINDER 7.0

Makes it easy to find files stored on the hard-disk drive by searching, for instance, by key word

TRUE TYPE

Creates sharp type on the screen and enlarges or shrinks it to any size

VIRTUAL MEMORY

Allows a computer to run large programs without using up all the memory by shifting unused portions of the program to the hard-disk drive

DATABASE ACCESS MANAGER

A built-in language that lets Mac application programs get information from a corporate database

INTERAPPLICATION COMMUNICATION

Links programs so that changes in data in one are reflected in another

FILE SHARING

Lets two Macs connect by cable so they can send data to each other easily. With an add-in card, a Mac and an IBM PC can be linked

DATA: COMPANY REPORTS, BW

Mexico
Is Sending
Business
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Cover Story

Macintosh is quite unlikely. While Sculley's hush-hush Advanced Technology Group keeps trying for that revolution in the back room, Sculley and Spindler are left with the task of running Apple today. Increasingly, that means doing business just as other computer makers do—adding bits and pieces of hardware and software to make their machines appealing to a wider range of customers.

Now, Sculley's R&D troops are encouraged to work with outside suppliers and adopt off-the-shelf technology when it will help get products out the door on time. That's a 180-degree change from the company's approach to technology under Gassée—and before him, Jobs. Both drove engineers to perfect proprietary Apple technology, even if it meant slower product introductions. Today, "there's an urgency here," says Spindler, who promises new Apple products every quarter in 1991. "Time to market has to be made shorter."

BREAK THE RULES. The deal to get a new laptop quickly by having it built by a Japanese subcontractor is the most striking example of how Apple is changing. "A year ago it would have been impossible to even discuss that, but Michael and John have really opened things up," says European Chief Olsson. Now, Apple executives say, no idea is off limits, no rules unbreakable. That includes the possibility of licensing portions of Apple's proprietary operating system to makers of IBM-compatible machines to broaden the Mac market.

Breaking rules is nothing new for Spindler. As president of Apple Europe, he didn't wait for marching orders. He took it upon himself to shake up the status quo by diluting each country manager's responsibilities for setting pricing and other policies. Prior to Spindler, each country had different dealer discounts. Prices varied by as much as 40% across the Continent. Spindler smashed those individual fiefdoms and made Apple Europe's strategy uniform. Now, the company is following Apple Europe's lead as it expands in Asia. In Japan alone, it expects to post \$1 billion in sales within the next few years. "The way Apple is working now at corporate headquarters under Michael is how we've always worked in Europe," says Olsson. "He hates business as usual."

To say the least, business as usual is not what Apple—or its customers or shareholders—want. By next year's management meeting, the verdict on the Sculley-Spindler team will be in. The two are gambling that by then, they'll both rate another standing ovation.

By Barbara Buell in Cupertino, Calif., with Jonathan B. Levine in Paris, and Neil Gross in Tokyo

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THERE IS NO SECOND PLACE

'THESE PEOPLE WERE USED AS GUINEA PIGS'

Uranium miners get a trust fund—and apology—from Congress

Ralph Ebberts went to work in southwest Colorado's uranium mines in 1950, grateful for a \$1.10-an-hour job in an area where people described themselves as being as poor as Job's turkey. He ate lunch underground, drank water scooped up from the mine floor with a tin can, and worked in dust so thick he couldn't see the light bulbs overhead. "The boss wouldn't start the fan until the big shots was coming," says Ebberts, now a rancher in Eggar, Colo. "We didn't even know what radon was."

He does now. Ebberts, 79, has had prostate and bladder cancer, and suffers from silicosis as well. "I can't sleep good for the achin' and the hurtin'," he says. Compounding Ebberts' pain is the bitter knowledge that the Atomic Energy Commission, predecessor to today's Nuclear Regulatory Commission, was well aware of the risks to him and other miners, yet did nothing. The miners themselves weren't any the wiser until health problems showed up years later.

Now, Ebberts and hundreds of other Western uranium miners who developed cancer and other diseases are finally gaining some relief. The Radiation Exposure Compensation Act, which cleared Congress on Sept. 28, would create a \$100 million trust fund to pay \$100,000 each to disabled uranium miners or their families.

NUCLEAR DAWN. In addition, the bill, which President Bush is expected to sign, will give \$50,000 each to residents of Utah, Arizona, and Nevada who developed similar ailments as a result of open-air nuclear testing. Up to 450 miners and 800 "downwinders" are eligible now, but since it takes years for the diseases to appear, others are sure to join their ranks.

Few of those miners had any idea back then that uranium could be deadly. In fact, in the early 1950s, when the

U.S. was in a nuclear-arms race with the Soviet Union, mining was a patriotic act. "These people were used as guinea pigs... in the life-and-death struggle with 'godless communism,'" says Representative Wayne Owens (D-Utah), a sponsor of the bill. One of the "guinea pigs" was Owens' own brother-in-law, a Marysville (Utah) miner who died of lung cancer two years ago. Owens himself remembers that as a boy, he got up at 4 a.m. to watch nuclear blasts light up the sky over his Panguitch (Utah) home.

The AEC, which was charged with building America's nuclear arsenal, was far better informed of the dangers of uranium. That's why, according to largely unrefuted congressional testimony, it allowed open-air nuclear testing only when the wind was blowing away from Las Vegas—and toward sparsely populated Utah. In the early 1950s, the U.S. Public Health Service warned the AEC

about the high radiation in uranium mines and suggested better ventilation to prevent decaying radon gas from attaching itself to dust particles that the miners then breathed into their lungs. The health service's concerns were well-founded: Early uranium miners developed lung cancer at 5 to 10 times the rate of the general population, according to later Public Health Service studies.

But the AEC ignored the advice, apparently figuring that if miners knew how dangerous working conditions were, they would quit. Stanley Brewer, a Cortez (Colo.) retiree who worked in the uranium industry for 20 years, says he would have "taken up another trade. Everyone who worked there was sacrificed to get the uranium out." Stanley's brothers Bennie and Melvin also worked in the mines. Both died of lung cancer in 1988. Stanley has lung problems that make even walking difficult.

MEDICAL BILLS. "There wasn't a man here who worked in the mine who didn't have a big chunk of ore in his house," says Walter Peabody, who had half a lung removed in 1954. His three young sons paid for the surgery by pooling the money they made baling hay during summer vacation. Today, Peabody owes some \$70,000 in medical bills, and he'll use the government money to pay debts.

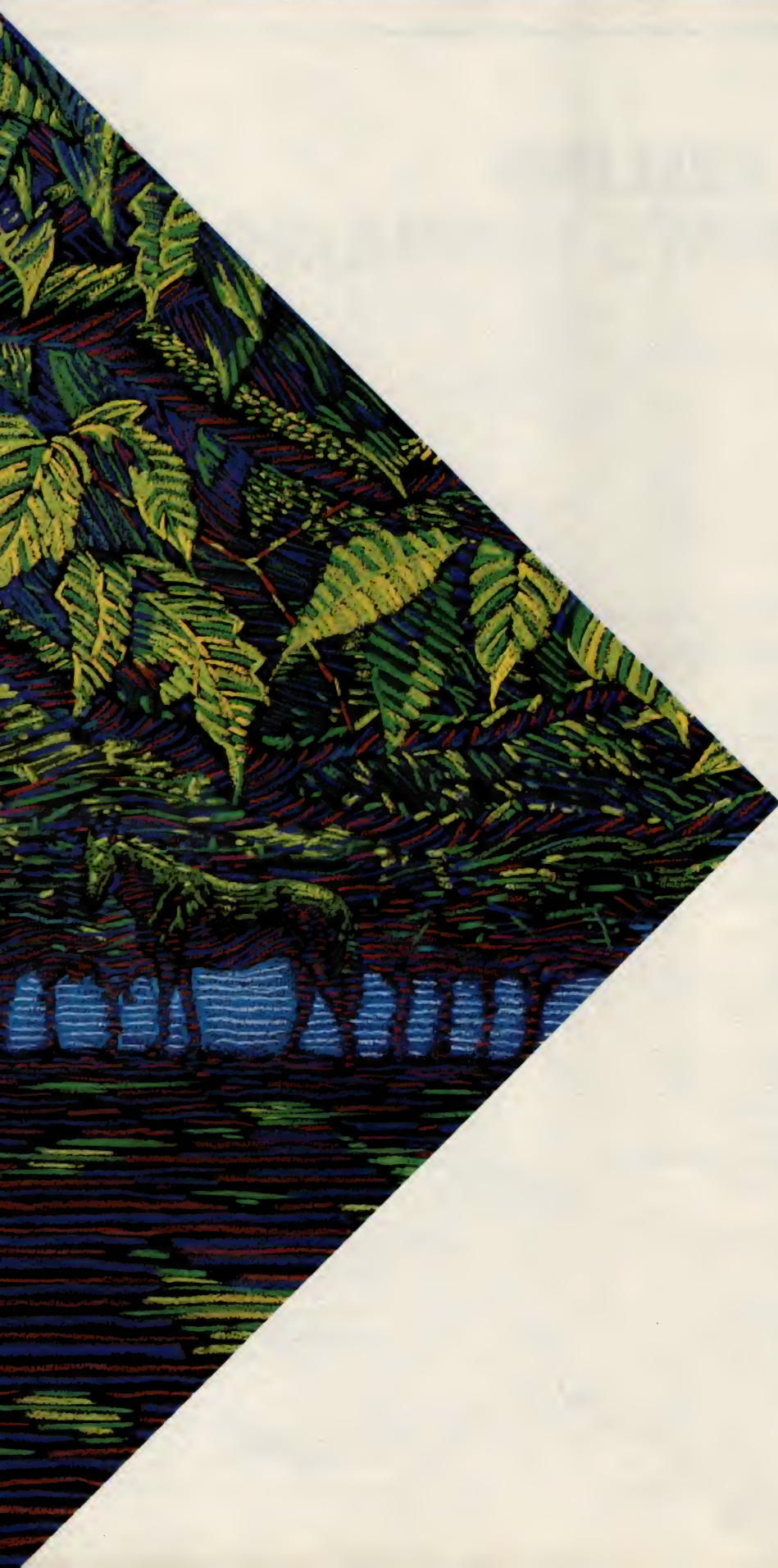
That's where most of the compensation will go. For years, the miners have tried to get help for their medical bills. In 1978, Stewart L. Udall, Interior Secretary under Presidents Kennedy and Johnson and now a Santa Fe (N.M.) lawyer, sued the government on behalf of a group of victims. But an appellate court ruled in 1987 that the government was protected by sovereign immunity, and in 1988, the Supreme Court refused to hear the case. Only a few miners have obtained worker's compensation or even welfare.

The bill contains a rare apology from Congress to the miners "for the hardships they have endured." But that is scant comfort to them or their widows. "If they could bring back the dead, it would be all right," says Yvonne Garcia of Cortez. Her husband, Rubel, was bedridden for seven years before dying of lung cancer last New Year's Eve. As for the apology? "It's a little late."

By Sandra D. Atchison in Cortez, Colo.



ENEMY MINE: VICTIMS EBBERTS AND BREWER MAY GET \$100,000 EACH



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FUNDS ARE REELING FROM SADDAM'S HAYMAKER

Equity funds dropped even faster than stocks in the third quarter. Only precious-metals funds gained

If one had to choose a single word to summarize the performance of equity mutual funds in the third quarter, it would have to be "yecch." With precious few exceptions, stock funds endured their worst declines since the calamitous fourth quarter of 1987.

Mutual funds have been pummelled since Aug. 2, when Saddam Hussein invaded Kuwait. And even though funds had high cash levels—12% in August, according to the Investment Company Institute—the cash cushion was not sufficient to keep funds from declining more rapidly than the overall market. The 1,107 equity funds tracked by Morningstar Inc. lost an average of 14.5%, nearly a full percentage point worse than the 13.7% decline in the Standard & Poor's 500-stock index. The decline for diversified funds—excluding specialized portfolios—was even worse, a stomach-churning 15.9% drop during the quarter. And the once-exuberant funds investing overseas turned sour despite a weakening dollar, declining 17% as foreign bourses fell even further than the U.S. market.

'REACTIVE.' Investors have begun to get cold feet—withdrawing \$2.78 billion from stock mutual funds in August, according to the latest ICI figures. "It's reactive," says Kurt Brouwer, a San Francisco money manager specializing in mutual funds. "If investors have a long-term time horizon, this is the time to buy."

If investors follow their usual—and unwise—pattern of buying into the best-performing category of the recent past, they will go for the gold. Among the broad categories tracked by Morning-

star, only precious-metals funds, which eked out a 4% gain, came out ahead at the end of the quarter. The worst-performing funds invested in technology and financial services stocks, which had some of the biggest declines, and in small over-the-counter issues.

Still, there were a few bright spots. The best-performing fund of the quarter, the Dreyfus Capital Value fund, had

Unlike most mutual funds, the Dreyfus fund has the flexibility to invest in stocks, bonds, and options, and it can also sell short. Salvigsen was bearish as the quarter began and deployed 12% of the fund's assets into short sales—of financial institution stocks, among other things—and placed 2% of the fund's cash into put options that gained as the Japanese market collapsed.

The above-par performance enjoyed by the Dreyfus fund was shared by other versatile "balanced" funds, as well as by asset-allocation funds. Both fund categories have tended to keep high cash levels and to deploy a good chunk of their holdings in bonds, which did not perform quite as miserably as stocks. That hurts them when equities are advancing but protects them when stocks nosedive.

Also enjoying comparatively better performance were funds investing in high-yielding stocks. As a result of their dividend-income stream, electric and gas utilities and the funds that invest in them were among the better (less bad, that is) performers of the quarter. For example, the Lindner Dividend Fund, which has a 10.5% yield and invests mostly in convertible preferred securities, declined just 2.6% during the quarter. "Utilities are pretty much resistant to downturns because of their yields," says portfolio manager Eric E. Ryback. "We've been buying them aggressively for the past year or so."

To come out unscathed, however, the only sure bet turned out to have been a perennial dog—the funds that own gold-mining stocks. Although several energy

HOW FUND CATEGORIES PERFORMED

	Total return*
ASSET ALLOCATION	-7.39%
AGGRESSIVE GROWTH	-20.82
BALANCED	-8.25
EQUITY-INCOME	-11.13
GROWTH	-15.67
GROWTH & INCOME	-12.68
INCOME	-7.43
INTERNATIONAL STOCK	-17.18
OPTION/INCOME	-10.04
SPECIALTY	-19.19
SMALL COMPANY	-22.14
SPECIALTY—FINANCIAL	-23.25
SPECIALTY—HEALTH	-10.95
SPECIALTY—NATURAL RESOURCES	-2.28
SPECIALTY—PRECIOUS METALS	3.97
SPECIALTY—TECHNOLOGY	-25.16
SPECIALTY—UTILITIES	-6.49
U.S. DIVERSIFIED EQUITY FUND AVERAGE	-15.85
EQUITY FUND AVERAGE	-14.49
S&P 500	-13.72

*Includes reinvested dividends and capital gains
DATA: MORNINGSTAR INC.

an uninspired showing in 1989, rising 25.3%, vs. 31.7% for the S&P. But in the most recent quarter it was a standout, gaining 13%—an annual rate actually better than the market's 1989 performance. "Our portfolio might have looked strange at the beginning of the quarter, but it really went up in lights," says portfolio manager Stanley Salvigsen.

mutual funds made it to the top of the rankings, funds investing in natural resources declined slightly during the quarter. By contrast, precious-metals funds managed to pull out ahead, as gold-mining shares advanced during the quarter because of the rise in the price of bullion. Gold advanced as high as \$425 during August, only to retreat beneath \$400 as tensions ebbed. Gold-mining stocks fluctuated wildly but ended the quarter ahead.

'SELL SIGNAL.' Among the precious-metals funds, the top spot was claimed by Toronto-based Blanchard Precious Metals fund, which invests mainly in North American gold-mining stocks. "We were still 20% in cash four months ago," says portfolio manager Peter C. Cavelti. "Then we decided we could do better, so we became more fully invested"—in time for the post-Saddam surge in gold prices. Good timing was also enjoyed by the managers of the Monitrend Value fund, which uses options to guard against market downturns. Senior portfolio manager Michael Licameli notes that the fund's technical indicators erupted in a "sell signal" on July 20, and the fund reacted by selling S&P index futures and futures on the New York Stock Exchange composite index to hedge its portfolio of blue-chip stocks. Result: The fund showed a 0.39% gain.

But the stellar performance of a handful of funds is little solace for most fund

The public is hardly
abandoning mutual funds—
and the outflow of cash
could easily reverse

customers. The most widely held funds performed poorly, with the biggest of them all—Fidelity Magellan—declining almost three percentage points more than the S&P index. For Magellan, that was the first full quarter under Morris Smith, who succeeded famed money manager Peter Lynch in May.

The public, however, is hardly abandoning mutual funds—and the flow of cash out of stock funds could easily reverse. The money withdrawn from stock funds during August was kept within the fund groups. When transfers within fund families are excluded from the figures, \$339 million actually flowed into stock funds. Investors are deploying the proceeds into money market mutual funds—where they can be transferred back into stock funds by just lifting a phone. And if the market shows any resilience, they'll probably do just that.

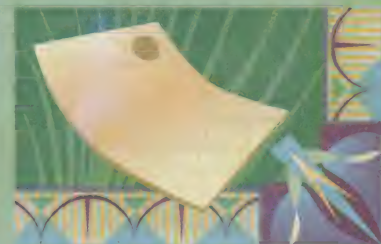
By Gary Weiss in New York

THE BEST AND WORST OF THE THIRD QUARTER

LEADERS		LAGGARDS	
Fund	Total return*	Fund	Total return*
Dreyfus Capital Value	12.96%	Prudent Speculator Leveraged	-46.63%
Blanchard Precious Metals	11.68	Bull & Bear Special Equities	-43.75
Enterprise Precious Metals	11.30	Security Ultra	-41.16
Strategic Investments	10.27	Steadman Ocean. Technology & Growth	-39.80
USAA Investment Gold	9.34	SLB Small Capitalization	-37.32
Thomson Prec. Metals & Natural Res. B	9.05	Security Omni	-35.49
Van Eck Gold/Resources	8.83	Alliance Technology	-33.21
Fidelity Select Energy	8.42	SteinRoe Capital Opportunities	-33.14
Scudder Gold	8.23	Delaware Group Trend	-32.67
Benham Gold Equities Index	7.45	Oberweis Emerging Growth	-31.91
Financial Strategic Energy	7.38	Fidelity Select Electronics	-31.76
Lexington Goldfund	7.22	Washington Area Growth	-31.69
IDS Precious Metals	6.75	FPA Capital	-31.24
SLB Precious Metals & Minerals	6.44	Seligman Communications & Information	-31.14
Kemper Gold	6.03	MFS Lifetime Emerging Growth	-30.83
Colonial Advanced Strategies Gold	5.98	Fidelity Select Software & Computer	-30.81
Merrill Lynch Natural Resources B	5.85	SunAmerica Equity Aggressive Growth	-30.80
Fidelity Select Energy Service	5.40	Twentieth Century Giftrust Investors	-30.74
Fidelity Select American Gold	4.97	AMEV Advantage Capital Appreciation	-30.58
SLB Precious Metals	4.93	Fidelity Select Financial Services	-29.89
United Services Global Resources	4.76	Dean Witter Developing Growth Secs.	-29.82
Fidelity Select Prec. Metals & Min.	4.75	Twentieth Century Vista Investors	-29.82
Equity Strategies	4.73	T. Rowe Price Science & Technology	-29.53
MainStay Gold & Precious Metals	4.44	Flag Investors Emerging Growth	-29.45
Keystone Precious Metals Holdings	4.29	Columbia Special	-29.31
Vanguard Specialized Energy	3.84	Fidelity Select Capital Goods	-29.18
United Services World Gold	3.70	SAFECO Growth	-29.15
Vanguard Specialized Gold/Prec. Metals	3.17	PBHG Growth	-29.13
International Investors	3.04	Transamerica Technology	-29.12
Rushmore Precious Metals Index Plus	2.45	Bull & Bear Capital Growth	-29.05
Kidder Peabody Special Growth	2.32	SLB Special Equities	-28.96
PaineWebber Master Energy-Utility	2.23	American Heritage	-28.85
Oppenheimer Ninety-Ten	2.02	Steadman Associated	-28.75
Colonial VIP Inflation Hedge	2.00	G.T. Japan Growth	-28.63
Excel Midas Gold Shares	1.79	Fidelity Select Automation/Machinery	-28.56
MFS Lifetime Gold & Precious Metals	1.63	Strategic Technology	-28.55
Bull & Bear Gold Investors	1.35	Sherman Dean	-28.44
Financial Strategic Gold	1.21	Wall Street	-28.40
Mathers	0.84	Kaufmann	-28.26
Franklin Gold	0.78	SFT Environmental Awareness	-27.68
United Gold & Government	0.70	Vance Sanders Special	-27.56
Freedom Gold & Government	0.44	Olympic Small Cap	-27.51
Monitrend Value	0.39	USAA Mutual Aggressive Growth	-27.50
Unified Income	0.37	Unified Growth	-27.19
Righttime Blue Chip	0.11	AFA National Telecommun. & Technology	-27.13

HOW THE LARGEST FUNDS FARED

	Total return*
FIDELITY MAGELLAN	-16.46%
WINDSOR	-20.34
INVESTMENT COMPANY OF AMERICA	-10.84
WASHINGTON MUTUAL INVESTORS	-13.13
FIDELITY PURITAN	-11.22
FIDELITY EQUITY-INCOME	-15.66
TEMPLETON WORLD	-17.80
PIONEER II	-17.11
AFFILIATED	-12.57
AMERICAN MUTUAL	-8.68



*Includes reinvested dividends and capital gains
DATA: MORNINGSTAR, INC.

MILKEN HAS EVERYTHING TO LOSE—AND LITTLE TO GAIN

It's unlikely the minitrial will boost his standing with the court

At last. After a decade of controversy over what Michael R. Milken did to Corporate America and how he did it, we're about to get as good a look as we'll ever get. A minitrial is set to begin on Oct. 11 to help decide whether he should do as little as no time in jail or as much as 28 years for six counts of largely technical violations of the securities laws. Although it won't be a full-fledged trial, a parade of witnesses will give testimony on the inner workings of Milken's junk-bond network at Drexel Burnham Lambert Inc.

While the peek into Milken's operations will help satisfy the public's curiosity, Milken is likely to be anything but satisfied. He has everything to lose and little to gain. He's at risk because Judge Kimba M. Wood has agreed to consider alleged crimes that were not among the six to which Milken pleaded guilty. And the relatively lax rules of evidence put the prosecution at an advantage. Still, Wood's strict timetable will force both sides to pursue their strategies carefully or lose the chance to introduce crucial evidence or testimony.

UPHILL BATTLE. It's hard to imagine Milken's standing with the court could improve. Judge Wood has already said that she agrees with Milken's defense team and scores of letter writers that Milken is both a devoted husband, father, and friend, and "hardworking, fair, and honest" in dealings with co-workers. She also agrees his many acts of charity began "well in advance of this investigation." Wood also has rejected government claims that Milken will break his promise to cooperate in further investigations after his sentencing. "I am assuming that Mr. Milken will do what he says he will do—that is, cooperate fully," Wood told prosecutors. In normal proceedings, that would suggest that Milken, who has already agreed to pay \$600 million in fines, was making headway in persuading the judge to let him off with a light sentence—perhaps, as his lawyers urge, working with inner-

city kids near his home in Encino, Calif.

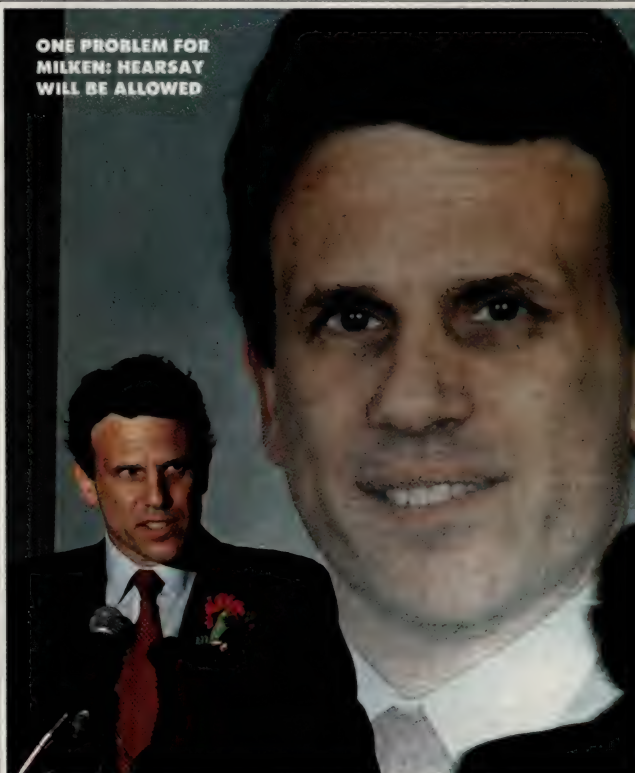
Now, however, Milken must face his accusers, and the hearing's ground rules will make an uphill battle even tougher. For one thing, the flexible rules of evidence in a sentencing hearing will let the government introduce hearsay and other evidence that ordinarily would be excluded. And prosecutors only have to prove

arbitrageur Ivan F. Boesky had an illicit arrangement with Milken that was designed to manipulate stock and commit other crimes. Even though prosecutors say Boesky is on the "short list" of witnesses they may use, they also have some good reasons for not calling him at all. Boesky might so dominate questioning that there would be little time for other witnesses. One option: The prosecutors could call only Boesky employees.

TICKING CLOCK. The problem for the defense is uncertainty. If they prepare for Boesky, and the prosecution doesn't call him, they'll have wasted valuable time. But if Boesky does appear, the defense will have to work fast to discredit him.

The time constraints will also force both sides to carefully allot their time on each of the four cases chosen by prosecutors. Three cases involve trading of

ONE PROBLEM FOR MILKEN: HEARSAY WILL BE ALLOWED



WITNESSES FOR THE PROSECUTION

IVAN F. BOESKY

Arbitrageur and convicted felon. Might corroborate sweeping allegations of an illegal, three-year trading scheme with Milken

DAVID B. SOLOMON

Money manager. Might testify that Milken provided lucrative investment opportunities in exchange for doing business with Drexel

CARY J. MAULTASCH

Former Drexel bond trader. Might detail allegedly illegal trading between Boesky and Drexel

PETER R. GARDINER

Former Drexel bond trader. Might discuss charges that Milken manipulated the stock of Wickes Cos.

their claims by a preponderance of the evidence instead of the tougher, beyond-a-reasonable-doubt standard. Wood has given each side just 20 hours to present evidence and to conduct cross-examination on four deals that she says represent a wide array of the other crimes Milken is alleged to have committed. But with a list of 14 possible witnesses for the prosecution alone, defense lawyer Arthur L. Liman won't have much time to go on fishing expeditions or impugn the witnesses' credibility. "We are in a very tight situation," Liman told Wood.

The case's star witness presents a challenge to the strategies of both sides, however. The government claims that

securities in Wickes, Caesars World, and MGM/UA Communications. The fourth, and most treacherous for the opposing lawyers, involves complex charges that Milken bribed investment-fund managers to buy securities used to finance the 1985 leveraged buyout of Storer Communications Inc. If either prosecution or defense becomes entangled in the details, they are likely to wind up simply confusing the judge. It's in the government's interest to "present as small a slice of that transaction as it can," says Wood. That might give the larger audience for the hearing just a taste of what they had hoped would be a feast.

By Michele B. Galen in New York

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VOLVO

Commentary/by Chris Welles

MIKE MILKEN IS NO ANGEL. BUT HE'S NOT SATAN EITHER

A hard-core criminal whose empire was rooted in illegality? Or a brilliant financial pioneer who slipped over the line and committed a few innocuous offenses?

U.S. District Court Judge Kimba M. Wood will weigh these divergent views of dethroned junk-market king Michael R. Milken in an extraordinary two-week hearing scheduled to start Oct. 11. She will eventually sentence Milken for six mostly minor felonies to which he pleaded guilty last April. But to get a clearer fix on whether Milken's wrongdoing was pervasive or aberrational, she acceded to a request by prosecutors to consider additional allegations (page 102).

The hearing, featuring testimony by numerous witnesses, will center on four instances that the government claims will demonstrate a more flagrant pattern of criminality than the counts to which Milken pleaded guilty. Some clues to how the hearings will turn out are contained in lengthy presentencing memorandums submitted recently to Wood by the government and defense. A comparison of arguments suggests that the outlook for Milken is not auspicious. The evidence shows a recurring willingness by Milken to use illicit tactics to bolster his powerful network of junk-bond issuers and buyers.

WEAK LINKS. True, Milken seems far from the nefarious villain depicted by the government. His crimes, such as parking stock, seem less blatant and contemptible, less indicative of an inveterate criminal mentality, than those committed by Ivan F. Boesky and your average penny-stock swindler. Although it scrutinized more than a million transactions and secured the cooperation, through immunity grants, of many people who worked closely with Milken, the government did not unearth systematic insider trading. Its memorandums contain only one allegation that Milken traded on inside information for personal gain. The facts in that instance, involving Caesar's World Inc. bonds, are ambiguous. This transaction will be considered in the Wood hearing. The government mentions three additional insider trades, but all were conducted by other Drexel

Burnham Lambert Inc. employees. Evidence directly linking Milken to the trading seems weak.

Although the government accuses Milken of "unlawfully influencing corporate events," it offers no evidence other than Victor Posner's acquisition of Fischbach Corp. in 1985 that Milken rigged takeover deals. The government further claims that Milken regularly cheated clients. As its principal example, the government charges that Milken masterminded schemes by a Drexel employee and an official with Princeton/Newport Partners to manipulate stock in Drexel clients COMB Co. and U.S. Home Corp. Drexel allegedly benefited from the

Inc. stock that Drexel client Golden Nugget Inc. wanted to unload. Milken said the scheme let Golden Nugget receive a "better price" for the stock. The Wood hearing will focus on another Boesky-related manipulation, allegedly to facilitate an exchange offer by Wickes Cos. The government's evidence of rigging in this case seems strong.

REAL TRAGEDY. The government is also persuasive, if not totally convincing, in alleging that Milken employed illegal tactics in his junk-market dealings. It asserts that Milken bribed money managers and other investors with lucrative investment opportunities to get them to buy junk offerings. The defense argues—not too credibly—that such inducements were legal, because the money managers bought into the opportunities at nonpreferential prices. The Wood hearing will examine the one case offered by the government of such alleged bribery: Drexel's financing of Kohlberg Kravis Roberts & Co.'s 1985 acquisition of Storer Communications Inc.

Although it offers no specifics, the government claims that buyers of junk offerings, especially hard-to-sell deals, were lured by Milken's promises to buy securities back later at no loss to the buyers. The defense claims such buybacks were at market prices. But as the government correctly points out, that ignores Milken's "enormous discretion" over junk prices.

It seems likely, in sum, that illicit accommodations and inducements were ingrained in Milken's modus operandi. But they were almost certainly not central to his power. Milken was a financial genius who would have been extremely successful without finagling. That is the real tragedy of his downfall.

There are other questions affecting how Milken's legacy should be judged, such as whether his achievements in creating the junk market outweigh his role in fostering the financial excesses of the 1980s. On balance, he probably did more good than harm. For now, though, it seems clear that Milken not only broke the law but broke it regularly. He deserves a few years in the slammer to think it over.



schemes at its clients' expense. Yet the government concedes evidence that Milken was directly involved in the manipulations is only "circumstantial." Federal investigators have contended that Milken's dealings with thrifts contributed to the savings-and-loan debacle. But the government's memorandums to Wood makes only two allegations related to S&Ls: stock-parking schemes with Columbia Savings & Loan Assn. that had negligible financial impact on the thrift.

The government is on firmer ground in contending that Milken often bent the law to help such clients as Boesky and junk-bond manager David B. Solomon evade taxes and commit other crimes. Milken, in turn, used Boesky to commit further illegal acts. Milken has already admitted to enlisting Boesky to buy MCA

The numbers outside.

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THE AWKWARD MATING DANCE OF CORROON AND WILLIS

Will the U.S. insurance broker's shareholders nix the British offer?

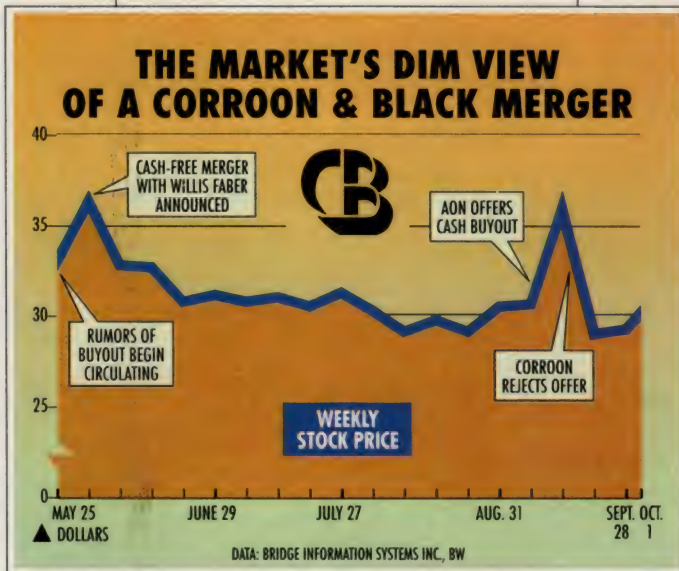
To its engineers, the merger of New York's Corroon & Black Corp. and London's Willis Faber PLC would create a transatlantic insurance dreadnought. With each company bringing its own extensive domestic network, the new Willis Corroon would be the world's fourth-largest insurance brokerage. "To sell insurance," says Corroon CEO Richard M. Miller, "you have to use natives."

Unfortunately, the 58-year-old Miller, who has staked his reputation on the \$643 million merger, is having trouble selling it to his shareholders. He plans a stock swap with Willis, worth about \$31 per share to Corroon shareholders. This has one big virtue: It costs the two partners next to nothing. The flip side is that nobody's shareholders get a premium. So, Aon Corp., a large Chicago-based insurer and broker, topped that by offering \$40 a share in cash for Corroon. Aon withdrew the \$840 million bid after Corroon's board rejected it. But **BUSINESS WEEK** has learned that Aon investment bankers are still at work on the proposal, apparently looking for an opening. Aon CEO Patrick G. Ryan says coyly: "If Corroon has an interest, we would expect them to call."

NO CASH DOWN. Disgruntled Corroon shareholders may make that happen after their votes are counted at a meeting scheduled for Oct. 8. "Aon provided better value to us," says DeWitt F. Bowman, chief investment officer at the California Public Employees Retirement Fund, the nation's largest public pension plan, which will vote its 106,200 shares against the merger. Arbitrageurs, led by Bear, Stearns & Co., have launched a campaign to persuade others to deep-six the Willis deal. At this point, says Michael A. Smith, an analyst at Shearson Lehman Brothers Inc., "the merger is a toss-up."

A plus for the Corroon-Willis marriage is that almost 30% of the American brokerage's stock is held by managers and employees. They have an incentive to

vote yes: A matchup with the foreign company is less likely to require staff reductions because Willis has no duplicative U.S. operations to pare. As an added enticement, Corroon pledges a \$2.50-per-share special dividend once the merger is approved. Willis, whose stockholders overwhelmingly accepted the plan on Sept. 28, remains committed to Corroon. Says Willis CEO Roger J. Elliott: "We are building an international business for the future."



That lofty notion hasn't exactly excited the market (chart). Just before the June merger announcement, buyout rumors made Corroon stock surge. Then, when Wall Street heard this was a cashless deal, it slumped again. The stock staged a brief rally after Aon's Sept. 12 bid, ending with the bow-out of the Chicago company, which says it doesn't want to make a hostile bid. Willis shares have fared similarly in London.

From a business standpoint, which

A Willis-Corroon union would end frustrating efforts by both companies to expand internationally

combination would be best? The readings are mixed. Willis and Corroon would give each other access to vast new markets. But Aon, as a multiline insurer that both writes and brokers insurance, has nine times Corroon's asset base of \$1 billion. That gives it more leverage to expand Corroon's business, since Willis has only two times Corroon's assets. For Aon, Corroon's appeal lies in its ability to beef up Aon's brokerage of property and casualty insurance—an area that is expected to recover next year from a devastating late-1980s price war. Corroon, which lines up coverage for midsize commercial clients, is well positioned to share in any rebound: After an anemic past four years, net income for 1990's first half was up 12% from the same period in 1989.

SECRET MEETING. A Willis-Corroon union, meanwhile, would end frustrating efforts by both companies to expand internationally. Corroon sought to buy Britain's Minet Holdings PLC in 1988, but St. Paul Cos. outbid it. Willis, which is expanding on the Continent, was thwarted in attempts to gain a big U.S. presence. It tried—and failed—to buy Johnson & Higgins, a large New York-based brokerage with which it had a century-old relationship of business referrals. The privately held concern wanted to remain independent.

To avoid upsetting this old partner, Elliott, 57, held his first meeting with Miller in February, at a suburban New York hotel where they were unlikely to be spotted. After hearing the Corroon news in June, a peeved Johnson & Higgins severed ties with Willis and sold a 5% stake in it.

If nothing else, Corroon and Willis would make a sociologically interesting pairing. Under Miller's patrician predecessor, Robert F. Corroon, the brokerage was modeled along the genteel lines of Willis, with a low-key pursuit of clients. But since Miller, an assertive former Marine, took over three years ago, Corroon has gone after business more forcefully. His strategy has included purchasing a raft of small brokerages. Miller, who would be second-in-command under Elliott, insists the two cultures can achieve harmony: "The British used to be overly civilized. Now, they are as aggressive as we are." Viewed in that light, the Corroon stockholder fight is a fitting introduction to American life.

By Larry Light in New York, with Richard A. Melcher in London and David Greising in Chicago



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BY GENE G. MARCIAL

SOME SURPRISING PICKS FROM SOGEN'S TOP PRO

Despite the market's recent rally and a break in oil prices, investment manager Jean-Marie Eveillard expects stocks to continue heading south. The president and investment chief of SoGen International Fund, a New York-based unit of France's Société Générale, is deeply worried not only by Saddam Hussein's next move but also by the U.S. economy's huge debt burden.

Eveillard has been a bear all year, and in July slashed SoGen's investment in equities to 35% from 50% early in the spring. Of the 35%, two-thirds is in U.S. issues. Eveillard prefers offbeat companies, and so far, that strategy has produced handsome returns for SoGen's \$200 million portfolio. Over the past decade, SoGen has had compounded yearly growth of 20%, vs. 17% for the Standard & Poor's 500-stock index.

Eveillard says two factors are essential to finding a winner: a "cheap price and favorable circumstances, in that order." Cheap, says Eveillard, means a relatively low price-to-earnings ratio as well as modest price-to-cash-flow and price-to-book-value multiples. "Favorable circumstances" means consistent growth of 15% to 20%, a strong balance sheet, unrecognized assets, and decent management, he says.

Eveillard has been buying conservatively run Republic New York, a commercial bank; Texas Instruments, a turnaround bet; and Thomas Nelson, a publisher of bibles and other religious books, because it's in a noncyclical business that shows solid growth and has a p-e of only 11 on estimated 1991 earnings. He also likes Allen Organ, a growth company that has been "extremely profitable," has lots of cash and no debt, and is expanding into overseas markets such as South Korea.

S&L WINNERS. But what will really raise eyebrows on the Street is that Eveillard is buying savings-and-loans. Some of his picks: New Jersey's New Charter One Bancorp (formerly Charter Federal Savings), Cleveland's Charter One Financial, and New Hampshire's Portsmouth Bank Shares. All have equity of 10% to 15% of total assets, with loan portfolios that are about 85% single-family residential mortgages. Eveillard notes that the loan portfolios have

A BIG BEAR'S FAVORITE STOCKS

	52-week high	Current price
ALLEN ORGAN	\$38 1/8	\$28 1/2
Electronic organs		
CHARTER ONE FINANCIAL	22	10 3/4
S&L		
HANCOCK FABRICS	41 1/4	34
Fabric retailer		
LONGVIEW FIBRE	14 1/8	10
Pulp and paper		
MANPOWER	18 1/4	10 5/8
Employment services		
REPUBLIC NEW YORK	52 3/8	39 3/8
Commercial bank		
TEXAS INSTRUMENTS	44	26 3/4
Semiconductors		
THOMAS NELSON	8 7/8	8 3/8
Bible publisher		

DATA: SOGEN INTERNATIONAL FUND, BW

grown at a modest 2% to 3% annually, indicating that these thrifts haven't been indiscriminate in their lending. And these S&Ls' loans are only 60% of deposits, he adds.

SoGen's biggest position in the U.S. is in Hancock Fabrics, a textile-retailing chain that has shown recession-resistant characteristics, says Eveillard. It posted an earnings jump of 24.4% in the second quarter despite an industry slump.

WHAT'S TISCH UP TO AT CHAMPION?

The Mideast crisis notwithstanding, it may be takeover season on Wall Street again. Many pros insist that with MCA in play and UAL's unions expected to get a loan commitment from banks for their buyout of the airline any day now, the question is: Where will the next deal strike?

Maybe in the paper-and-forest-products group. Says one New York investment banker: "Assets in the industry have become way undervalued, making it an ideal target for strategic asset buyers, especially those from Europe."

Some money managers who have started scooping up shares of paper companies agree. Their top bet: Champion International, one of the world's largest paper producers. Earnings have declined in recent quarters. That, plus the market dive and the oil-price leap, caused the stock to skid to 24 in late September. Since then, some organized buying has emerged, lifting the shares to 27. Champion owns or controls 6.4 million acres of timberland.

"The stock is a cheap buy at current levels," says Joe Kasputys, president of Primark, which has clearance from the Federal Trade Commission to buy more than \$15 million worth of Champion's shares—about 560,000 at the current price—out of 93 million shares outstanding. Kasputys wouldn't say how many shares he has accumulated.

Larry Tisch has also stepped up his buying of Champion stock, raising his stake to 10.99% from less than 4% in April. Through Loews, of which he's chairman and CEO, Tisch is seeking FTC clearance to buy more than 15% of Champion's shares. Tisch is believed to be intent on raising Loews's stake to 20%, and he is seen as the potential catalyst for pressuring Champion executives into taking steps to boost the stock price. Management owns a stake of about 1%.

Analysts put Champion's asset value at \$70 a share. Says one: "Champion sells for 73% of its stated book value, the deepest discount in the paper-and-forest-products group." A Champion spokesman declined comment.

SUN MAY BE READY TO SHINE

Shares of Sun, the big oil refiner and marketer, have dived from 41 in June to a 52-week low of 31. That may make it the next big play in the volatile oil game.

Why? The surge in oil prices has clobbered oil refiners and petroleum-product marketers because President Bush won't allow them to fully pass on crude's recent price jump to customers. That has crimped margins. But what if oil prices broke precipitously? Some big investors believe that could happen, and they're putting their money on Sun. Since the company's largest cost is crude, "its margins spike up every time oil prices fall," notes Fred Leuffer, a veteran oil-industry analyst at C. J. Lawrence, Morgan Grenfell.

"When the oil crisis eases, Sun will be among the best-positioned companies to benefit because it runs its refineries more efficiently and at higher operating rates," adds Leuffer. And Sun's sophisticated refineries can process heavier—and much cheaper—crude than many rivals can.

Leuffer says the stock should hit 40 once earnings regain momentum, which he expects over the next two to three quarters. For next year, he sees a rise to \$3 a share from a projected \$2.80 this year, vs. last year's 92¢.

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EVEN FOR MICHAEL OVITZ, \$8 BILLION IS A BIG DEAL

The superagent plays matchmaker between Matsushita and MCA

It was a talent agent's dream. Dustin Hoffman, cradling his Oscar for his leading role in *Rain Man*, was doling out the traditional thank yous. Near the top of the list, right after co-star Tom Cruise, was superstar agent Michael Ovitz. "He made this project stick with glue even when it was falling apart," Hoffman told the packed Shrine Auditorium crowd.

For most of the last decade, Ovitz has arguably been the most powerful man in Hollywood. A martial arts expert, the sandy-haired, 43-year-old talent agent has forced films to be made, stopped others, and even helped topple the head of a major studio. Operating more like a studio than a talent agency, his Creative Artists Agency has skillfully packaged film and TV projects with heavyweights such as Bill Murray, Robert Redford, and Steven Spielberg. For the past two years, however, the super-secretive Ovitz has also become a point man for Hollywood's wave of corporate dealmaking.

MR. ROLODEX. Since early this year, Ovitz has been scouting for a Hollywood studio for Japanese electronics giant Matsushita Electric Industrial Co. Several weeks ago, according to sources close to the deal, Ovitz brought together Matsushita and MCA representatives at MCA Inc.'s New York offices for an exploratory meeting. On Oct. 7, the two companies are expected to begin fleshing out the details of a Matsushita buyout of the Los Angeles film and theme park company. Sources say that Matsushita is willing to pay \$6 billion for MCA's movie and record subsidiaries. MCA is said to want nearly \$8 billion for the entire company.

Ovitz declines to comment. But industry types say the CAA chairman is driven by



OVITZ HAS BEEN SCOUTING FOR MATSUSHITA SINCE EARLY 1990

grand ambitions. He has been luring Harvard-trained MBAs away from studios and Wall Street firms for over a year so that he can add corporate clients to the TV and movie stars who bring his 75-agent firm an estimated \$75 million a year in billings. Last year, CAA helped Canadian-based Archer Communications Inc. license its sound system to TV-commercial and record producers.

Ovitz was elevated to corporate dealmaking's big time in late 1989 when he advised Sony Corp. on its \$3.4 billion purchase of Columbia Pictures. Sony hired Ovitz during the previous summer. "He gave us advice about who was key and influential at various companies," says Michael Shulhof, Sony Corp. of America's chairman.

Until then, Ovitz was known primarily for packaging CAA stars, directors, and CAA-commissioned scripts for star-struck studios. With his mogul-rich Rolodex, Ovitz lined up meetings for Shulhof and Walter R. Yetnikoff, an Ovitz friend and head of Sony's CBS Records unit. "Michael knows how to get people together," says longtime friend Michael D. Eisner, Walt Disney Co. chairman. "In another business, he'd be called an investment banker."

Ovitz' assessment of a prospect's upcoming movie and TV projects was critical. Sony backed away from MGM/UA Communications Co., in part, because the price was too high for a debt-laden stu-

dio that wasn't luring top talent. Columbia, by contrast, had revived its production schedule after firing British filmmaker David T. Puttnam.

The Puttnam episode showed Ovitz' clout. The agent put CAA's roster off-limits to Columbia, hastening the firing of the studio executive. When Dawn Steel was installed as Puttnam's successor, Ovitz lined up Bill Murray, Dan Akroyd, and the other *Ghostbusters* actors to make the sequel that had eluded her predecessor.

Matsushita hired Ovitz shortly after the Columbia deal on the recommendation of Seiichiro Niwa, a key executive of Matsushita subsidiary Victor Co. of Japan Ltd. The 51%-owned video unit was in the midst of making a \$100 million investment with Hollywood producer Lawrence Gordon. It was also negotiating a distribution deal for MCA records. Ovitz' office denies any involvement in either deal. But for much of the last year, the Hollywood agent has been shuttling between Los Angeles and Osaka to keep Matsushita executives up to date on the mood in Hollywood.

MCA has had on-again, off-again merger talks with Paramount Communications Inc. over the years. Last year, talks broke down because Paramount Chairman Martin S. Davis and MCA Chairman Lew Wasserman could never agree on who would run the combined company. This spring, say sources, Ovitz contacted MCA's investment bankers at Lazard Frères & Co.

HOMETOWN BOY. The MCA deal would represent a milestone for Ovitz. A Los Angeles native who went to high school with Michael Milken, he rose from the mail room at the William Morris Agency to become a TV agent. In 1975, he and five others broke away to start their own agency. Hollywood insiders say CAA was paid \$10 million for the Columbia deal and could make \$50 million if the MCA deal is completed.

So does Michael Ovitz want to take the next step and run a studio? That's the most persistent rumor in Hollywood these days, though CAA officials vigorously deny it. Some industry executives think he would sell off the agency to head a Matsushita-owned MCA. But the deal may never happen. MCA has engaged in takeover talks before. Ovitz may be able to put movie projects together with glue, but making an \$8 billion takeover stick is now out of his hands.

By Ronald Grover in Los Angeles, with Susan Duffy in New York

THE BIG PLAYERS IN MCA

Holder	Number of shares Millions
DAVID GEFEN*	9.8**
CAPITAL GROUP FUNDS	5.3
LEW WASSERMAN, CEO	4.9
ESTATE OF FOUNDER JULES STEIN	3.9
SIDNEY SHEINBERG, COO	1.3
TOTAL COMMON OUTSTANDING	83.2

*Chairman of David Geffen Co., acquired by MCA in April

**Includes convertible preferred shares

DATA: COMPANY REPORTS

JAPAN'S HOLLYWOOD: MORE OMINOUS THAN IT SEEMS

When Sony snapped up Columbia Pictures a year ago, there was a loud outcry over the selling of a bit of America's soul to the Japanese. Sony Corp. executives summarily dismissed the howls as racism. But in fact, Americans had good reason to feel uneasy, and the pending marriage of Matsushita Electric Industrial Co. and MCA Inc. should trip the same alarms. These deals are bound to strengthen our toughest rivals in high technology.

At first blush, such arguments may seem overblown. Japan, after all, is no threat in entertainment. Hollywood is hardly Silicon Valley. And America wrote off consumer electronics more than a decade ago. But the media/technology conglomerates Sony and Matsushita envision constitute a new model of vertical integration. Unlike any existing companies, these two will control both the medium and the message in what the Japanese call the New Information Age.

Both companies understand that the high-tech landscape is changing. Lines between consumer and industrial electronics are blurring as computer, audio, and video technologies converge. Already in Japan, companies that sell color TVs also make the hottest laptops. Sony's Trinitron wizardry has made it a leader in high-resolution computer displays. Sony also builds successful workstations, while Matsushita is developing supercomputers.

MULTIMEDIA MAGIC. Both companies are also leaders in high-definition television, which uses computer-like circuitry to deliver film-quality pictures. The next frontier may be multimedia machines, where the consumer commands his own world of audio and video data. Applications will include more realistic computer games, training simulations, and even movies in which the user directs the plot. "Multimedia caught the imagination of the Japanese market faster than anywhere else in

the world," says Apple Computer Chairman John Sculley.

American computer companies are working feverishly on developing these businesses, too. But if the Hollywood sell-off continues, U.S. outfits may find the path barred by high-tech Japanese media giants that could use American movies and TV programming to help give their hardware the edge—first in Japan, then everywhere else.

Sony has already shown how owning recorded entertainment such as music, movies, and TV shows can help launch new electronics products—the "synergy" that Sony President Norio Ohga says justifies the move into entertainment. For example, Sony is stamping

American recording artists who are worried about inadequate copyright safeguards.

The next testing ground for the synergy formula may be HDTV. Under pressure from the Big Three networks, the Federal Communications Commission blocked Japan's satellite-based "Hi-Vision" system from becoming a U.S. standard. That gave American HDTV hopefuls such as Zenith Electronics Corp. some time to develop equipment, which, unlike Japan's version, would be compatible with today's television. But with Columbia and MCA, Sony and Matsushita could generate years' worth of HDTV programming—giving Japanese consumers a reason to

shell out thousands of dollars for one of the new sets. If, as a result, prices for HDTVs begin plummeting, companies such as Sony and Matsushita could probably rally American consumer support. That would make it tough for the U.S. industry to chart its own course in next-generation television.

OVERDRIVE. Synergy, of course, is just one ingredient. Plain economics is another. Demand for entertainment programming from American networks and cable-TV operators was worth about \$7.4 billion in 1987, according to Prudential-Bache Securities Inc., and it should reach

\$11.4 billion by next year. Japanese demand, starting from a smaller base, is growing even faster. Cable TV is exploding. New satellite channels are coming on stream. Programming for the HDTV market alone could be a \$9 billion business by the year 2000.

Aggressive investments in Hollywood by Japan's electronics companies are designed to supply that need. And if hybrid technologies such as multimedia take off, demand for programming could go into overdrive. American entertainment companies will see plenty of action. But by managing both sides of the business, Japanese companies have every intention of ending up in the driver's seat.



Columbia films into 8-mm tape for sale in Japan and the U.S. Eventually, they'll hit the rental shops, where they will help fan the sales of Sony's already red-hot 8-mm camcorders.

A Sony win in camcorders is harmless enough. No American company makes them. But even where Americans have no comparable hardware product, Japan's "synergy" can cause problems in the U.S. market. Take digital audiotape recorders. Critics warned in 1987, when Sony bought CBS Records, that the music giant could wind up as a launchpad for Japanese DATs. Sure enough, titles under the CBS label will start popping up next month on shelves in Tokyo, despite a lawsuit by

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OIL



YAMANI: "WE MUST REGULATE THE PRICE OF OIL, EVEN AGAINST ANTITRUST LAWS"

LOOK WHO'S BUBBLING BACK TO THE SURFACE

Former Saudi Oil Minister Yamani wants to play oil power broker

The timing couldn't be better. Two months into the Persian Gulf crisis, several hundred oil industry movers and shakers from around the globe will gather in London on Oct. 8 for a two-day conference. Among those scheduled to take the rostrum are the chairmen of four big oil companies, the Energy Ministers of Venezuela and Egypt, and Kuwait's Finance Minister, Ali Khalifa al-Sabah, who for years was that nation's Oil Minister. "It's the highest grade of speakers I have ever seen," marvels a sponsor of a rival conference.

Who brought these glittering names together? None other than Ahmed Zaki Yamani, the former Saudi Arabian Oil Minister. Until his 1986 sacking, Yamani reigned for more than two decades as the oil world's most influential figure. Out of favor at home, the 60-year-old lawyer largely disappeared from public view. But he quietly resurfaced early this year, when he founded a London-based think tank devoted to oil issues. The October conference, sponsored by Yamani's new Centre for Global Energy Studies, represents a coming-out of sorts. No doubt about it: Yamani is trying to forge a comeback.

Suave and diplomatic as ever, Yamani

dismisses the notion that he's seeking a political resurrection in Saudi Arabia, where his relations with King Fahd remain cool. Rather, he professes a genuine desire to use his myriad contacts to play a mediating role among producers, consumers, and oil companies—working for market stability. Sitting behind an enormous antique desk in his opulent and well-guarded London office, he warns that the world economy is about to take another disastrous ride on the oil-price roller coaster. "I see again a sharp drop in oil prices, then another increase," he says. "We can avoid this."

Yamani's solution begins with the same siren song of moderate, stable oil prices that marked his days in power. "There's a long-term mutual interest between consumers and producers," he says. Yamani favors keeping oil at about \$18 a barrel. That would give consumers an affordable supply, while providing a secure market for producers. He even proposes that consuming nations help fund capacity expansion in countries with big reserves—enhancing the interdependence of seller and buyer.

Indeed, Yamani says that current high oil prices don't reflect economic realities. "It's nothing but panic by the oil compa-

nies," which are keeping some 100 days' worth of inventory on hand for fear of supply interruptions. If these levels hold through the high-demand winter months, Yamani says \$60 oil is inevitable—and that's without war, which might push prices to \$100 if Saudi facilities were destroyed. But if companies slim down to 90 days' supply, he predicts that demand will ease, and prices will slip to the low 20s. To achieve that, he figures oil companies will have to collude—or be forced by governments to collaborate: "We must regulate the price of oil, even against antitrust laws."

Surprisingly, Yamani is optimistic despite the current standoff in the gulf. Once it is resolved, he says, cooperation might come easier. Facing up to Saddam Hussein "is like surgery to remove a cancer. The patient will be healthier afterward," he says. "I think the major powers will work hard to settle all the problems in the area, including the Arab-Israeli conflict."

That's certainly a welcome view. But is anybody listening? It's hard to tell. Joseph Stanislaw of Cambridge Energy Research Associates in Paris notes that Yamani "has a wealth of experience in dealing with this type of situation." Still, while Yamani has some big-name associates, one gulf oil official points out that most members of his advisory council are "formers," such as former West German Chancellor Helmut Schmidt and former U.S. Energy Secretary James Schlesinger. "Their influence is very limited. They're from Yamani's own era, which is past," says the official. Yamani, he adds, "is on an ego trip."

NO MORE PATSY. Yamani also carries political baggage that weakens his statesman role. Many in the oil world avoid getting too close to a man fallen from grace at the powerful Saudi court. "He's an intelligent commentator and a great personality," says one major oil company executive, who declined to be named for fear of offending Yamani. "But anybody who does business with the Saudi government has to be extremely careful" about dealing with Yamani.

Indeed, senior royal family members, including King Fahd, blame him for the mid-1980s oil revenue decline that sent the Saudi economy reeling. In fact, Yamani's policy of raising oil production and bringing down prices helped his country in the long run, says Massachusetts Institute of Technology economist Morris A. Adelman, by letting other OPEC members know they paid a price for overproducing at Saudi expense. Saudi Arabia "turned down being patsy to being policeman," he says. But Yamani "had to go because he had been



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Industries

the messenger bringing the bad news."

Younger Saudi technocrats also blamed Yamani—for failing to modernize the oil industry and neglecting to put Saudis in key positions. "The quickest way to lose friends in Saudi Arabia is to say you're a buddy of Yamani's," says a top royal family adviser in Riyadh.

Such Saudi hostility now hampers Yamani's business. "You cannot have that kind of organization run by somebody who does not have contact with the Saudis," says a well-placed gulf oil official. Another irony is that Yamani's Saudi ties may also hinder his relations with Iran and Iraq. No one on his advisory board or speaker platform is well-connected in either country.

A COMMON WALL. Yamani, with a personal fortune estimated at well over \$100 million, professes disinterest in his political standing. Indeed, he installed his new \$1 million-a-year center in a 19th-century mansion next door to the Saudi government's main London oil office. The two even share a common wall and a small parking lot. Nevertheless, he continues wooing oil industry heavyweights. "He's still very much a man of the court," says a European oil executive, who recently declined an invitation to visit Yamani's sumptuous Sardinian villa.

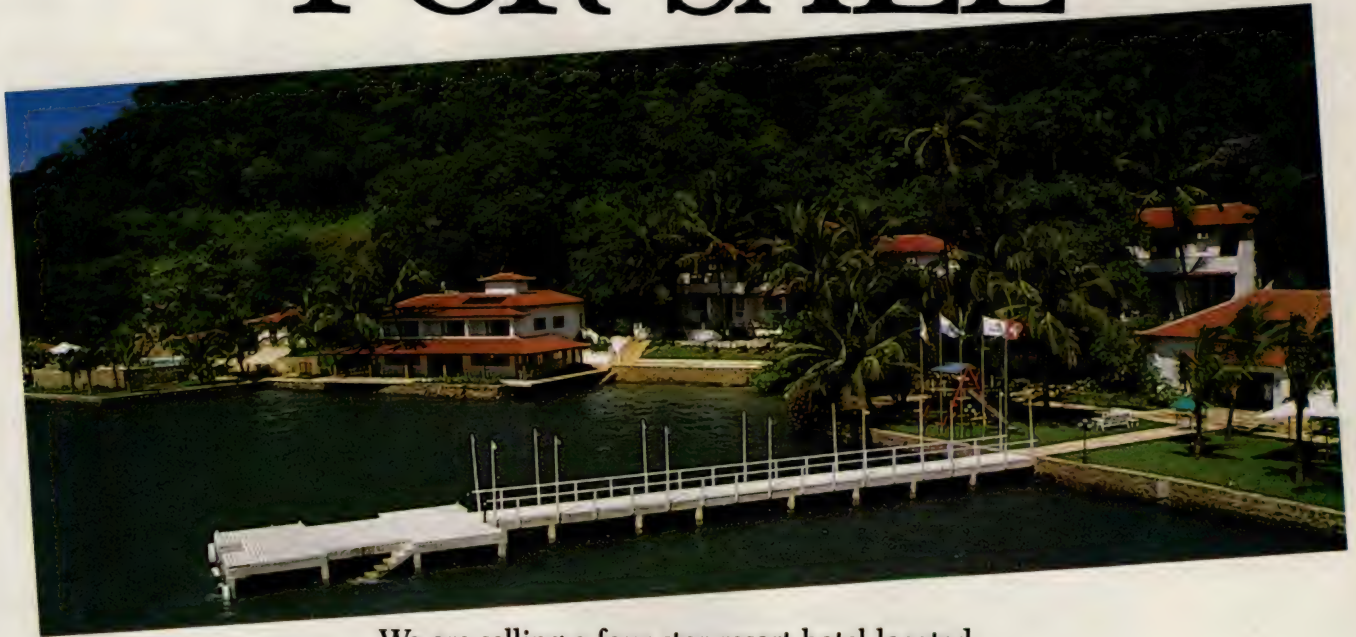
When not talking about oil, Yamani spends time on his yacht in the Mediterranean or at homes scattered around Europe and Saudi Arabia—where his current wife and their five children spend most of the year. Fascinated by ancient manuscripts, he is trying to preserve rare texts on optical disks. Yamani is also a keen perfume mixer, sometimes spraying his concoctions on visitors. And in 1988, he gained control of a Swiss luxury watchmaker. He plans to modernize its production and double sales by 1992, to 10,000 units a year.

Even detractors concede that Yamani, who was educated at Harvard and New York Universities, has a razor-sharp mind and enormous charm. He also remembers those who stand by him. In the 1975 kidnapping of Yamani and other OPEC ministers by the terrorist Carlos, a Libyan delegate was killed while trying to fend off the intruders. Yamani has quietly taken care of the man's family ever since.

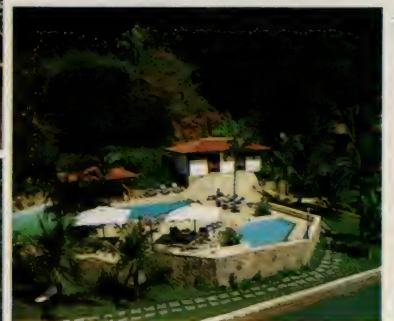
Such loyalty is one reason Yamani, even out of power, commands attention. "People want to keep in touch," says a high-level oil executive. "The dice may turn in Saudi Arabia. With a different leadership, he could be back in a powerful position." In the meantime, the one-time king of oil is at least back in the limelight.

By Mark Maremont in London, with John Rossant in Rome

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BASEBALL

THE BASEBALL OWNERS GET BEANED

Clubs will pay dearly for colluding—but weak teams will hurt most

When a few hardline baseball owners pushed for a lockout last spring, other clubs went along—for a few weeks. But as the start of the season approached, a majority of owners lost their stomach for a protracted fight and shoved through a settlement two weeks before opening day. The reason was simple. Flush with cash from fat new TV contracts that will bring in \$1.5 billion by 1994, most owners just weren't that worried about escalating player salaries.

But since Sept. 17, the wad in the owners' pockets hasn't felt quite so thick. That was when an arbitrator slapped the clubs with \$102.5 million in fines for colluding to violate the players' labor contract. With more damages pending, Major League Baseball's 26 owners may end up owing as much as \$10 million each. That's almost half of the increase each club will get from new TV contracts in the next three years.

Even more troubling for owners, the ruling suggests that salaries may remain at higher levels. This is sure to renew griping by clubs in smaller cities, which were the primary force behind the lockout. "The decision proves there's no realistic mechanism to suppress bidding on players," says Roger C. Noll, a Stanford Univer-

sity economist who has done work for the players' union. "This will lower the value of new and existing franchises."

The ruling is the latest setback in the owners' decade-long efforts to control player pay. In the mid-1980s, after double-digit salary increases, owners decided simply to stop bidding on free agents, who, with six or more years in the majors, can sell their skills to the highest-bidding club. The effort worked like magic, and salaries plunged from more than 38% of league revenues to about 31% last year (chart). However, arbitrators ruled that the action violated the union's labor pact.

Most owners brushed off the arbitrator's \$10.5 million assessment for collusion in the 1986 season. In fact, afterwards, they set up a data bank to share salary-offer information. But the latest decision, on 1987 and 1988, can't be ignored. The owners and the Major League Baseball Players Assn. both put forth formulas for determining the salary levels that should have been produced by a collusion-free market. The owners pegged the difference between collusion-free and actual levels at about \$55 million. The players put it at some \$125 million. The arbitrator adopted the players' formula with a few revisions. The \$102.5 million now will be divided among

players hurt by collusion. Some, such as Andre Dawson of the Chicago Cubs, stand to gain more than \$1 million.

Under the ruling, players will collect about the same share of revenues as they did before collusion. And unless owners want to risk still another costly ruling, they may have to pay such levels indefinitely. "Clearly, the arbitrator has taken the union's position almost entirely," says Gary Roberts, a vice-dean at Tulane University's law school.

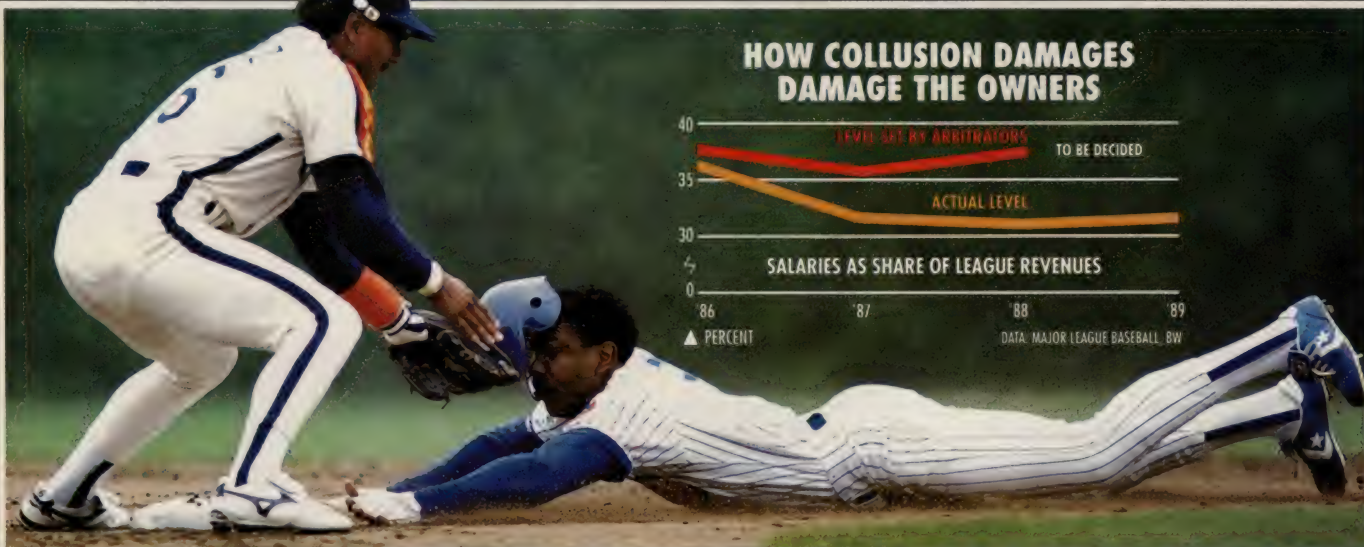
BIG BITE. Owners weren't expecting such high damages. A league contingency fund contains some \$4 million per club. But when possible interest charges and damages for the 1989 and 1990 seasons are factored in, each team could wind up paying some \$10 million.

The decision strikes smaller-city clubs particularly hard. They have complained for years that their big-city rivals use lucrative local media revenues—which aren't shared among teams—to send salaries out of the park. The five poorest teams had player payrolls that averaged \$8.5 million in the late 1980s, compared with payrolls of \$16.5 million at five rich clubs. The fines "will have a hell of a different impact on a small club than on, say, the Mets," says Louis A. Guth, an economist hired by the owners.

When the lockout was resolved last spring, both sides agreed to form a committee to study baseball's problems. It's charged with examining the owners' idea of capping total salaries at a certain percentage of revenues. With the battle over collusion largely over, the committee may get off the ground. But now, the players will be bargaining from an even stronger position. The likely result: more squabbles over money as both sides grow richer and richer.

By Aaron Bernstein in New York

HOW COLLUSION DAMAGES DAMAGE THE OWNERS



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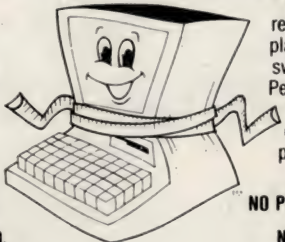
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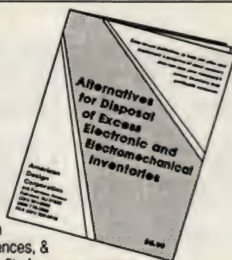
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As conglomerates head back to the basics, more of their disparate divisions are being cast out of the corporate fold and onto the street—Wall Street, that is. Such “spin-off” stock usually arrives in shareholders’ mailboxes with little or no fanfare. In the bull market of the 1980s, many investors who held these newly independent entities saw them generate impressive short-term returns. But in a declining market, should you risk betting on such unseasoned stock?

These corporate castoffs have had a good track record. In May, 1990, a Bear Stearns study showed that about half of the companies spun off from 1984 to 1988 appreciated more than 50%. Some rocketed even higher: York International and Masco Industries rose nearly 300%. No wonder that achieving quick capital gains with spin-offs used to

be compared to shooting fish in a barrel.

But it’s no longer a no-brainer. “The message isn’t that every spin-off is a buy,” says analyst Frederick Wise, who authored the Bear Stearns study. Now, “it’s that they’re a well-defined area for uncovering attractive values.”

HANDICAPS. Corporations spin off companies for a variety of reasons. Some spin-offs are fast-growing divisions that are stifled in a huge corporation. Others are just misfits. One well-known example is General Mills’s 1985 spin-off of Kenner Parker, its toy business. “The cereal business is a high-margin, predictable business,” says Scott Greiper, managing analyst of *Bits & Pieces*, an institutional research report of spin-off valuations. “The toy business is unpredictable and capital-intensive. The two didn’t belong together.” Two years after being spun off at 16, Kenner

Parker was acquired by Tonka for 51.

Interestingly, Kenner had been a troubled division under General Mills. The toy company is a good example of how a lackluster division can become profitable once it’s on its own. Freed from corporate bureaucracy, management can be more focused and entrepreneurial. And if the spin-off merits a higher value now, raising capital may be easier.

But many spin-offs start with handicaps. They don’t have great balance sheets and are highly leveraged. Parent companies may demand an “upstream cash dividend,” so the new concern may have to take on more debt.

Buying corporations’ spun-off stocks is no longer a no-brainer

Even in their heyday, some spin-offs deserved their reputation as dogs—divisions that dragged down the earnings of their corporate parents and wouldn’t fetch an attractive price if sold. In fact, Wise found that 25% of the spin-offs from 1984 to 1988 saw price declines ranging from 3% to 65%.

Indeed, the knee-jerk reaction to spin-off stock is to dump it, and selling pressure is heavy in the first few months of trading. Shareholders who got, say, one spin-off share for 10 shares of the parent company may not want an odd lot (fewer than 100 shares) in a company they know little about. Then, there are index mutual funds that can invest only in stocks in the S&P 500. And pension-fund managers may dump the stocks because most of these issues don’t pay dividends.

Some analysts recommend treating a spin-off stock like a

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Spin-off	Parent	Day one...	...and six months later
INTERTAN January, 1987	TANDY	\$11.25	\$19.75
FISHER SCIENTIFIC March, 1987	HENLEY GROUP	14.50	20.00
BURLINGTON RESOURCES December, 1988	BURLINGTON NORTHERN	31.38	44.88

...BUT NEW ONES ARE STALLED

PROMUS February, 1990	HOLIDAY CORP.	26.88	26.25
HENLEY PROPERTIES January, 1990	HENLEY GROUP	10.25	6.00
AEROVOX February, 1990	COOPER INDUSTRIES	3.50	4.06

DATA: BEAR, STEARNS & CO., BW

hot potato—at first. Prices often trend down when a spin-off is thrown on the market but bounce back within six months. The tricky part is buying the stock back at the low. That strategy would have worked with Time Warner's December, 1989, spin-off of TV-broadcast company BHC Communications, says Greiper, "because it was a total value play that snuck out the back door of Time Warner. No one knew about it." BHC first closed at 49½, but six weeks later it had fallen to 41¾. Two months after that, it closed at 48¾.

BACKFIRE. But with a spin-off that has a wider analyst following and higher acknowledged growth potential, selling the stock quickly could backfire. Take Burlington Northern's 1988 spin-off of Burlington Resources, the railroad company's energy op-

erations. "If I sold my stock and bought it back a few months later, I would have sold Burlington at 25 and bought it back at 45," says Arnold Schneidler, president of investment advisers A.R. Schneidler & Co., based in New York.

What makes for a good spin-off? Those in businesses that are unlike the parent company's may be more attractive, since analysts won't be familiar with the industry and may undervalue the stock. Greiper considers it another good sign if manage-

ment stays on and has performance incentives such as stock options.

In this market, Wise thinks defense and real estate spin-offs look intriguing. He says: "Given the way these areas are hated by the market and shunned by investors, we could see some attractive values for long-term, value-oriented investors." Schneidler, on the other hand, looks for undervalued niche companies in the hazardous-waste, environmental, and natural-gas industries.

Two spin-offs Greiper likes and thinks are undervalued are Vivra, a dialysis-services business, and BHC. But while Greiper still has faith in the long-term value of spin-offs, he is covering his bets. In an upcoming research report, he's unveiling a new strategy vis-à-vis spin-offs: how to sell one short. *Suzanne Woolley*

Education

TAKING TIME OUT FOR A FELLOWSHIP

Susan Clymer was a fast-rising executive at California Biotechnology. But she suddenly jumped off the corporate ladder at the Mountain View (Calif.) company to take a scholarly year in Japan. Now, she spends her days interviewing biotech experts in government, universities, and industry.

If you've ever envied academics their freedom to take sabbaticals, sigh no more. Many fellowships are open to those in the business world. Of course, some mid-career grants are for specific professions. But a surprising number welcome applications from any sort of executive.

CUSTOM-TAILORED. Take the prestigious Fulbright scholarships. Annually, 30 of them are given for a year of business-oriented teaching or research in almost every country—and professional experience can be as good as a Ph.D. "It's really the match

between skills and credentials that's most important," explains Steve Blodgett of the Council for the International Exchange of Scholars in Washington, which administers the program.

Of course, to get a Fulbright, you can't just blithely apply to study fishing in the Bahamas. You have to tailor the application to the stated needs of individual countries. Projects can be carried out in the field or in the classroom.

Professionals struck by wanderlust should also check out the Luce Scholars program. It sends 18 young (under-30) Americans to work in Asia for a year. The foundation targets those who have had little exposure to Asia.

For example, James O'Connor, a management consultant at Monitor Co. in Cambridge, Mass., had never been out of the U.S. before he got the Luce. While working as a stock analyst for Lucky-Gold-

star in Seoul, he got a sense of what it's like to be an outsider. Also, he says, "it really opened my sensitivity toward working with people from different cultures."

Not all such grants send people abroad. Each year, the White House Fellows pro-



gram selects 11 to 19 fellows from various professions and assigns them to a year either in the White House itself or at an executive branch department or agency. Fellows have a chance to meet with top

government officials and work with Cabinet members. In a typical year, there are more than 1,000 who apply.

The White House selection commission is looking for people who are dedicated to serving the community. Being a fellow "doesn't necessarily translate into immediate individual benefits, and those who expect it to would be better off not applying," warns Elaine Chao, a former fellow who, after her stint, left banking and is now Deputy Transportation Secretary.

Persuading your company to let you go may be a bigger hurdle than getting the fellowship. Susan Clymer resigned from Cal Biotech to accept her Fulbright. Still, she's glad she did.

Companies are banging on her door, eager to use her knowledge of the Japanese system in arranging joint biotech deals. "It's been a quantum leap in career opportunities," she says. *Peter Hong*

Autos

THE CAPRI: MERCURY'S PITCH TO MIATA FANS

Inevitably, Mercury's new Capri is compared with Mazda's Miata. After all, both are seductive, sporty rag-tops in the same price category. On the road, the Miata offers more pure, rip-snorting fun. But the Capri carries a dose of practicality that makes it an attractive alternative for the workaday world of commuting, ferrying kids, and buying groceries.

A similar, 1.6-liter Mazda engine powers both cars. But while the Capri feels plenty zippy, it's not quite as quick as the Miata. It has fewer horses, for one thing: 100 compared with 116.

The Italian-styled Capri is also a bigger, heavier car, wedge-shaped and more angular than the curvaceous Miata. With front-wheel drive, as opposed to a roadster's traditional rear-wheel drive, and

with softer springs, the Capri has a hard time putting power on the pavement—especially when it comes to aggressive



A BACK SEAT AND A REAL TRUNK, TOO: THE 132-HORSEPOWER XR2

cornering on bumpy roads.

Other than that, the Capri is a joy. The top stows under a small lid, providing a neat, trim appearance even with the

roof down. And the cockpit controls are simple and easy to use. Plus, the driver's seat has a thoughtful, if slightly cumbersome, height-adjustment feature.

Where the Capri really shines, though, is in storage space. Unlike the Miata, it has a back seat, complete with shoulder belts. Of course, it's strictly for kids and small

duffle bags. With the top down, even a 10-speed bike (sans wheels) makes it.

NICE PRICE. Best of all, there's actually usable trunk space. Grocery bags fit standing up, as do bike wheels, and there's room for several pieces of soft luggage. Its convertible top isn't quite as convenient. The Capri's soft top can be doffed or donned in just a minute, but you have to get out to perform the operation, while the Miata's top can be moved from the driver's seat.

The Capri is attractively priced. The base model goes for just \$12,943, including delivery. That compares with \$14,000 for the lowest-cost Miata. The Capri XR2, with 132 horsepower for more neck-snapping acceleration, weighs in at \$15,877. It gets 25 miles to the gallon, slightly less than the base model's 27 miles to the gallon.

Sometimes it's tough to rationalize shelling out that much for an overgrown toy. But when practical transportation comes in a package that promises fun—hey, no problem. *David Woodruff*

Smart Money

WITH WINE FUTURES, YOU CAN ALWAYS SWALLOW THE LOSSES

It was hot and dry in the Bordeaux region of France this summer—just the kind of climatic conditions that can produce a wonderful vintage. And now that it's harvest time, connoisseurs and investors are wondering whether they should lock in prices by buying Bordeaux wine futures.

Futures are contracts that cover the price of a specific number of cases of wine for delivery 18 to 24 months after harvest. Wine merchants offer futures in the spring following the vintage.

BUYING FRENZY. Contracts for 1989 Bordeaux have been incredibly popular. Indeed, there was a buying frenzy after some experts began describing it as the vintage of the century. At Sherry-Lehmann Inc., a New York wine merchant, futures on '89 Château Haut-Brion were first offered last May at \$850 a case. Now they're \$895.

Of course, in part this re-

flects the depreciation of the dollar against the franc. Still, there's no doubt that wine futures represent the lowest price, because wine appreciates in price once it's bottled. For example, futures on '82 Château Latour were first

offered in the spring of 1983 at \$495 a case. The same 12 bottles currently go for \$1,679 at retail in New York.

Although futures are available for many wines, investors and oenophiles covet the rich, expensive reds of

Bordeaux. Investors often limit themselves to the region's top châteaux, including such stars as Latour, Margaux, Mouton-Rothschild, Haut-Brion, and Cheval Blanc (table).

Still, there are risks in wine futures—even for these blue-chip labels. Futures are first offered when the wines are in their infancy, so it's hard to judge

whether they will turn out to be first-class. Although you may not lose money, your profits may suffer. For example, a Haut-Brion Graves from 1983, a so-so year, was first offered at \$440 a case in 1984; in 1986, the retail case price was only \$540.

FIVE YEARS. Also, wine investing takes patience. Most experts advise holding on to your wine for at least five years before selling. Even so, it won't be easy to cash in on your investment. Most states prohibit individuals from selling wine without a liquor license. That often means having to employ an auction house.

And what of the 1990 vintage? While many are singing its praises, there's already some dissent. Wine critic Robert Parker Jr., publisher of the *Wine Advocate*, thinks the grapes may be of uneven quality. It may have been *too* hot and dry in Bordeaux. *John Meehan*

WHAT A DIFFERENCE A YEAR MAKES

Chateau	Current futures prices	
	1988	1989
MOUTON-ROTHSCHILD	\$650	\$950
MARGAUX	650	860
LATOUR	625	850
HAUT-BRION	625	895
CHEVAL BLANC	665	880

DATA: SHERRY-LEHMANN INC.

A woman with long, dark, wavy hair is sitting on a large, light-colored, textured rock. She is wearing a red, sleeveless, form-fitting dress. She is barefoot and has three beaded anklets on her left ankle. She is leaning back on her right hand, resting her head on it, and looking towards the camera. The background is a large, craggy rock face.

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Yet isn't it worth it for the woman you love?

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Travel

WHERE A SLICE COULD LAND YOU DEEP IN THE JUNGLE

Everyone knows about the golf boom in Japan, where 168 new courses have sprouted in the past two years, and green fees range from \$70 to \$200. But golf is becoming more serious business throughout Southeast Asia: Formal and challenging, it's one of the best routes to the region's royals and corporate chiefs. In Bangkok, American Chamber of Commerce Executive Director Tom Seale tells newly arrived executives: "If you really want to get plugged into this society, play golf."

U.S. companies with Asian operations, such as 3M and Citibank, are realizing the importance of golf in Asia and are paying lifetime membership fees that can range from \$20,000 in Bangkok to \$114,000 in Singapore. If your company hasn't coughed up yet, you can play Asian courses on a per-day basis if you have a handicap certificate from your home club.

But don't depend on hotel brochures' promises of access to a club. Call before arriving to prevent your game from being swamped by Japanese on a whirlwind two-day tour. Most places will probably be most welcoming on weekdays.

Any sportsman worth his spikes will relish the contrast between Thailand's finely manicured slopes and the jungle-like setting of courses in the Malaysian highlands, where you can report that you literally played with a bunch of monkeys. Despite the often rugged conditions, however, golf in Asia is a formal affair. Leave the shorts and T-shirts at home. Asians particularly cringe at foul language or displays of temper, even on that seventh sand trap by the lagoon filled with

fever-carrying mosquitoes. That said, here's where you can have fun and post a good score for your company at the same time:

■ **The Philippines.** The designs of the courses may not be the best, but they are among the more interesting and affordable in Asia. Executives might avoid the military-run

Across the narrow straits with Singapore, the Royal Johor Country Club (607-22-88-82) is the place to be, although memberships are closely held and rules fit for royals are strictly enforced. Wear shoes with spiked soles—no rubber studs.

In Penang, home to many American electronics ventures, there's Bukit Jambul Golf Club (604-84-28-13). Dotted with rubber and cashew trees, this new, rocky course offers short, exciting play.

■ **Singapore.** It's tiny, but it has 11 clubs and 17 courses. Given two weeks' notice, the

the Pondok Indah Golf & Country Club (6221-769-4906) is less snooty than Jakarta's newer and flashier courses. At 630 yards from the blue tee, the ninth hole is one of the longest in the world. Down in Bandung, a popular conference town, there's the Dago Golf Course. It's a snappy little course, but watch out for the wandering chickens.

■ **Thailand.** The hottest golf spot in Asia, its green fees range from \$12 to \$50. Breathtaking backgrounds abound, from temples and limestone cliffs at the Royal Hua Hin (032-51-24-75), Thailand's oldest course, to the surrounding race-track at the downtown Royal Bangkok Sports Club (251-0181). But even the best courses have their drawbacks. At Khao Yai, about 50 miles out of Bangkok, you could lose the ball in a steaming elephant dropping.

If you come alone, you'll be teamed up with others—a great way to make contacts, notes Simon Edmonds, who runs World Splendour Holidays (662 271-0611), a Bangkok golf tour organizer. But bone up on Thai customs. A pat on the back is the biggest insult you can give your partner, short of crossing your legs. And take a wallet along, since the locals love to bet: Deputy Prime Minister Pramual Sabhavasut wagers 3 million baht (\$160,000) per game. But despite all this, don't take it too seriously. For golf in Thailand, as in all of Asia, the operative words are "sabai" and "sanuk"—that is, "laid-back" and "fun."

Dinah Lee, Mark Timm



Thailand is one of Southeast Asia's hottest spots for golf, with exotic tropical surroundings and modest green fees

Villamor Course, the choice of Japanese holiday golfers, in favor of El Club Intramuros (632-47-84-70). With fees of \$9 to \$13 a day, it's the shortest course in Manila, perfect for a morning round. Watch out for the "Marcos gimme," named after the late President Marcos: This is a ball that can be claimed as in the hole if it falls anywhere within 100 feet of it. For more tips, contact the Philippines Golf Assn. in Manila. Sharp Travel Services (632-81-70-169) specializes in golf tours.

■ **Malaysia.** Nowhere will the golfer feel closer to the jungle than here. The Hyatt Hotel offers guests access to the brutal new Cobra course designed by Californian Ronald Fream at the Saujana Golf & Country Club (603 746-1188).

Singapore Tourist Promotion Board (65-339-6622) can arrange access to the Tanha Merah (65-542-3040), a popular club near Changi Airport. Also highly regarded: the Sentosa's Tanjong Course (65-275-0022). As your ball flies over the Strait of Malacca at sunset, the view is stunning.

■ **Indonesia.** A favorite of Vice-President Sudharmono,

Worth Noting

■ **ALL ABOARD.** A new European East Pass, modeled on the West's popular Eurail-pass, becomes effective on Jan. 1. Good in Austria, Czechoslovakia, Hungary, and Poland, it allows five days of first-class train travel in any 15-day period for

\$160, or 10 days of rides within a month for \$260. Details: 800 848-7245.

■ **A PICTURE WORTH...** For those who hate instruction manuals, Panasonic gives free videocassettes that show how to use its desktop and laptop word processors. Forthcoming: a tape on waterproofing camcorders for Cousteau-like shots.

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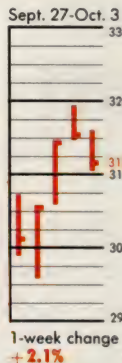
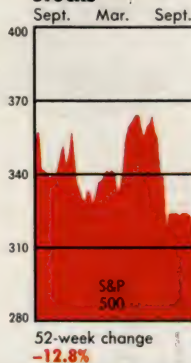


Investment Figures of the Week

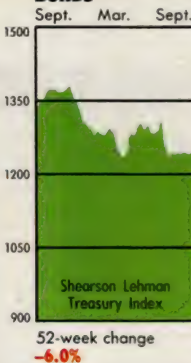
COMMENTARY

The markets ended the worst quarter since 1987, and October got off to a good start. Oil prices backed down from \$40 per barrel. Bush and congressional leaders cobbled together a deficit reduction package. Bonds rallied, with yields dropping from 9.1% to 8.9%. That gave U.S. stocks a modest rebound. In Japan, the government announced measures to shore up the ailing stock market. In response, the Nikkei jumped 2,677 points, or 13.2%, on Oct. 2, its biggest gain ever.

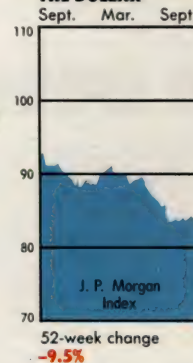
STOCKS



BONDS



THE DOLLAR



MARKET ANALYSIS

U. S. STOCKS

	Latest	Week	% change 52-week
DOW JONES INDUSTRIALS	2489.4	1.2	-10.2
BIG COMPANIES (Russell 1000)	160.8	2.1	-14.7
SMALL COMPANIES (Russell 2000)	128.1	-0.5	-28.6
ALL COMPANIES (Russell 3000)	170.1	1.9	-15.6

FOREIGN STOCKS

	Latest	Week	% change (local currency) 52-week
LONDON (FINANCIAL TIMES 100)	2087.0	4.4	-9.7
TOKYO (NIKKEI INDEX)	22,849.4	1.1	-36.4
TORONTO (TSE COMPOSITE)	3179.5	-0.1	-20.9

FUNDAMENTALS

	Latest	Week ago	Year ago
90-DAY TREASURY BILL YIELD	7.4%	7.6%	8.1%
30-YEAR TREASURY BOND YIELD	8.9%	9.1%	8.2%
S&P 500 DIVIDEND YIELD	3.2%	3.8%	2.9%
S&P 500 PRICE/EARNINGS RATIO	13.5	14.3	14.9

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 26-week moving average	342.3	343.5	Negative
Stocks above 26-week moving average	15.1%	13.5%	Positive
Speculative sentiment: Put/call ratio	0.53	0.61	Positive
Insider sentiment: Vickers sell/buy ratio	0.72	0.73	Positive

INDUSTRY GROUPS

FOUR-WEEK LEADERS

	4-week	% change 52-week
1 HEALTH CARE SERVICES	16.8	19.3
2 REGIONAL TELEPHONE COMPANIES	10.3	-2.1
3 COAL	8.8	5.3
4 TOBACCO	6.2	12.9
5 NATURAL GAS DISTRIBUTION	5.4	-2.2

FOUR-WEEK LAGGARDS

	4-week	% change 52-week
1 HOTELS AND MOTELS	-25.2	-71.6
2 APPAREL MANUFACTURING	-16.7	-32.6
3 PERSONAL LOANS	-16.5	-43.2
4 HOMEBUILDING	-16.1	-54.0
5 MONEY CENTER BANKS	-15.5	-50.8

Strongest stock in group

	4-week	% change 52-week	Price
MANOR CARE	17.2	-6.0	13½
AMERITECH	17.0	2.4	64¾
PITTSTON	12.5	4.9	21¾
AMERICAN BRANDS	7.8	-5.6	72¼
ONEOK	19.2	1.6	15½

Weakest stock in group

	4-week	% change 52-week	Price
MARRIOTT	-34.7	-68.5	11¾
V. F.	-25.9	-58.8	14½
HOUSEHOLD INTERNATIONAL	-21.7	-53.3	27½
U. S. HOME	-58.3	-72.2	¾
CHASE MANHATTAN	-33.1	-71.7	11¾

BRIDGE INFORMATION SYSTEMS INC.

MUTUAL FUNDS

LEADERS

Four-week total return	%
1. SLB TELECOMMUNICATIONS INCOME	8.1
2. DREYFUS CAPITAL VALUE	3.5
3. EATON VANCE TOTAL RETURN	2.3

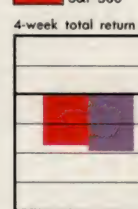
LAGGARDS

Four-week total return	%
G. T. JAPAN GROWTH	-20.0
BULL & BEAR SPECIAL EQUITIES	-18.8
JAPAN	-17.5

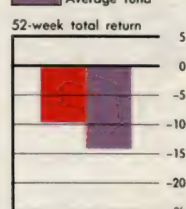
52-week total return	%
1. EQUITY STRATEGIES	56.1
2. FIDELITY SELECT ENERGY SERVICE	38.3
3. FIDELITY SELECT BIOTECHNOLOGY	25.8

52-week total return	%
PRUDENT SPECULATOR LEVERAGED	-51.4
STEADMAN OCEANOGRAPHIC TECHNOLOGY	-47.8
WASHINGTON AREA GROWTH	-44.0

S&P 500



Average fund



MORNINGSTAR INC.

RELATIVE PORTFOLIOS

Dollar amounts represent the present value of \$10,000 invested one year ago in each portfolio

Percentages indicate five-day total returns



DATA RESOURCES INC.

All data on this page are as of market close Wednesday, Oct. 3, 1990, unless otherwise indicated. Industry groups include S&P 500 companies only; performance and share prices are as of market close

Oct. 2. Mutual fund returns are as of Sept. 28. Relative portfolios are valued as of Oct. 2. A more detailed explanation of this page is available on request.

GOOD WORK ON THE BUDGET—BUT

President Bush and congressional negotiators deserve two cheers for the budget agreement reached on Sept. 30. One huzzah is for turning their backs on the smoke and mirrors that surrounded similar efforts in the past. Second, they deserve a cheer for finally coming to terms with the nation's need for an energy tax.

Although it falls well short of the promised \$50 billion reduction in the fiscal 1991 deficit, the total saving of \$500 billion over five years and the relative freedom from the sort of stunts and accounting tricks that have marred past budget pacts are praiseworthy. Congress should get on with the job of translating the agreement into law as fast as it can prudently do so.

The budget package contains a series of consumption taxes that together figure to raise \$10 billion a year after they kick in on Jan. 1. The largest of these, an additional 12¢ in federal excise taxes on each gallon of gasoline sold, is a serious step toward discouraging wasteful energy consumption as well as being a revenue-raiser. The so-called sin taxes on alcoholic beverages and cigarettes also combine laudable social purpose with additional cash for federal coffers. And while the 10% excise tax on luxury items such as furs, yachts, and limousines probably won't raise all that much money, it has a Puritan quality about it that is consistent with a country caught up in an international showdown, with scarcely enough money to pay for it.

But there is room for significant improvement within the broad outlines of the agreement. A few simple steps would greatly enhance the fairness and economic efficiency of some of its tax and budget proposals.

First off, lawmakers should scrap the overly generous 25% deduction for investment in small business and some

related tax breaks for small companies. The main beneficiaries of this one are likely to be tax lawyers and tax-shelter promoters. And rather than spurring innovative, high-tech companies, the tax break could end up mainly benefiting publicly owned fast-food franchises. For the same amount of foregone revenue or less, Congress could provide for indexation of capital gains so that investors would no longer be taxed on illusory inflationary profits.

The other prime candidate for the scrap heap is the new limitation on itemized deductions for taxpayers earning more than 100,000 a year. The proposal, as drafted, adds a mind-numbing layer of complexity to the tax code. And because the \$100,000 limitation applies equally to joint and single filers, it exacerbates the unfair and unwise "marriage penalty" in tax policy.

The effect of this provision is to raise the marginal rate on the highest-income taxpayers by about a percentage point, even though lawmakers can claim not to have raised rates. There's no reason to indulge this inane fiction. Why not simply raise the rate one point and be done with it? It won't cost anyone an extra penny and should earn the gratitude of anyone who has to wade through a Form 1040.

Finally, while the budgeteers decided correctly that some of the benefits to the elderly should be trimmed, the way they chose to do it is unconscionable. Over the next five years, \$60 billion is to come out of the medicare program, half in higher premiums and copayments, half from reduced fees to providers. It makes no sense to heap the burden on the ailing old, regardless of income. It would be vastly more fair to shift the burden to the better-off elderly by increasing the share of Social Security benefits subject to the income tax.

IT'S TIME FOR GREENSPAN TO KEEP HIS PLEDGE

It is urgent that the Fed ease—and ease fast. Federal Reserve Board Chairman Alan Greenspan promised an easing in the wake of a credible budget package. Such a budget deal is apparently in place and with some changes is likely to go through both houses. This is a significant, \$500 billion package that is the first real effort in a decade to bring the deficit under control. The bond market has reacted positively, signaling that it regards the package as viable. Now is the time for the Fed to honor its promise.

There is a timing problem, because some of the new taxes and spending cuts will begin to depress the economy well before monetary policy—which always works with a lag—can kick in to offset them. But the data are beginning to fit Greenspan's rigorous definition of a recession: what he has called a "cumulative unwinding" of economic activity. The data for August were uniformly negative, and we are beginning to get numbers for September that are equally down-

beat. Another reason the Fed needs to act is to prevent the recession from becoming a drawn-out affair. The sooner the Fed loosens credit by cutting interest rates, the quicker the pain of this downturn will be over.

Chairman Greenspan says he is worried about inflation because the underlying trend of prices (outside food and energy) is upward. This concern seems unwarranted because the weakness of the economy is certain to slow down inflation next year. The Fed is worrying about today's inflation rate when it ought to be worrying instead about tomorrow's economy.

In the past year, the economy has been weak but growing. But what happens to a Sears or a Chase if we have four quarters of recession? What happens to corporate profits? The failure of the Fed to ease right now, at least to mitigate the effects of the recession, could cause serious problems in some of the fragile sectors of the economy.



UNCOMPROMISING
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LONDON DRY GIN

47% Alc./Vol. 100% Grain Neutral Spirits. Imported by Hiram Walker & Sons, Inc., Farmington Hills, MI. © 1990.

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THINGS ABOUT BEING
170 YEARS OLD
IS THAT IT PUTS THE
IMPORTANCE OF
BEING FASHIONABLE
IN A PROPER
PERSPECTIVE.



Maybe we'll build anoth Maybe

Incomprehensible as it may seem, in any given month, we rarely build two Porsche cars that are identical.

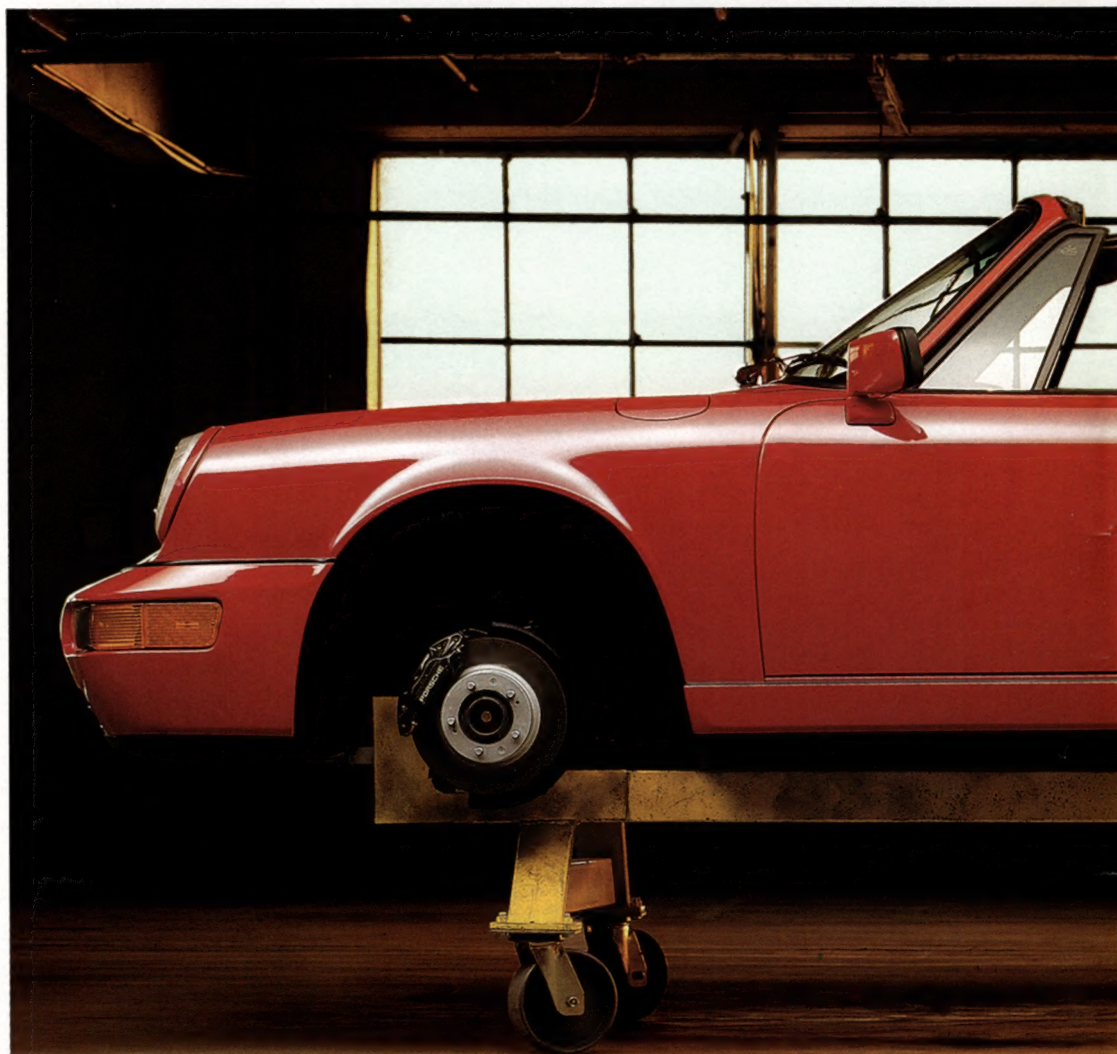
The simple fact is, it was never Professor Porsche's intention to build a lot of cars. Just a limited number of very special sports cars, for perfectionists like himself who could appreciate them.

It is this fierce individuality and self-expression which has always made a Porsche a Porsche. First, we do things our own way technologically. Seeking the most perfect solution. Then, we virtually sculpt each vehicle into a distinctive statement for the individual who will occupy it.

The new generation 911 Carrera 4 Cabriolet is the latest evolution in this rather unconventional philosophy.

Simply by virtue of its Porsche heritage and construction, it stands uniquely apart. Welding alone takes over 4 working days for each body. Engines are bench-built by hand. Convertible tops are individually hand-stitched, then hand-assembled.

Incorporating an electronic all-wheel drive system that makes it literally a landmark car, the Carrera 4 elevates sports cars to a new level of useable power and performance.



The new Porsche 911 Carrera 4 Cabriolet.

her like it next month. not.



It is after all this, however, that each Porsche truly becomes singular, allowing for individualization almost unheard of in this day and age. We offer over 350 different seat variations. Our current exterior color palette numbers 13, but we have available over 200 selections, including every production color we have ever used. You could even have the same silver that Professor Porsche used on his first roadster in 1947.

Or, send us a sample to match. One gentleman provided us with his girlfriend's lipstick. A woman sent a swatch of her favorite dress. After a tour, one customer wrote, "In many ways,

your plant has more in common with an artist's workshop than with a 'normal' automobile factory."

Of course, all this takes time. Which is why we can only promise 776 Carrera 4 Cabriolets to the U.S. this year. Ample reason to make time soon for a test-drive at your authorized Porsche dealership.

But be forewarned: If you acquire one, and can't wait to exchange a knowing wave with someone on the road in a car just like yours, don't hold your breath. You may never see one.



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